



**ASIC**

Australian Securities & Investments Commission

## REGULATION IMPACT STATEMENT

# Risk management systems of responsible entities

March 2017

### **About this Regulation Impact Statement**

This Regulation Impact Statement (RIS) addresses ASIC's proposals to release additional regulatory guidance for responsible entities on our expectations for compliance with their existing obligation to maintain adequate risk management systems.

## What this Regulation Impact Statement is about

- 1 This Regulation Impact Statement (RIS) addresses ASIC's proposals to give additional guidance to responsible entities on our expectations for compliance with their existing obligation under s912A(1)(h) of the *Corporations Act 2001* (Corporations Act) to maintain adequate risk management systems.
- 2 In developing our final position, we have considered the regulatory and financial impact of our proposals. We are aiming to strike an appropriate balance between:
  - (a) maintaining, facilitating and improving the performance of the financial system and entities in it;
  - (b) promoting confident and informed participation by investors and consumers in the financial system; and
  - (c) administering the law effectively and with minimal procedural requirements.
- 3 This RIS sets out our assessment of the regulatory and financial impacts of our proposed policy and our achievement of this balance. It deals with:
  - (a) the likely compliance costs;
  - (b) the likely effect on competition; and
  - (c) other impacts, costs and benefits.

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## A Executive summary

### What is the problem ASIC is trying to solve?

- 4 Under s912A(1)(h) of the Corporations Act, Australian financial services (AFS) licensees have an ongoing legal obligation to have adequate risk management systems. Responsible entities as AFS licensees are subject to this ongoing obligation.
- 5 [Regulatory Guide 104](#) *Licensing: Meeting the general obligations* (RG 104) provides general guidance for AFS licensees (including responsible entities) about what is required to meet this obligation.
- 6 There is currently no tailored guidance for responsible entities on what is required to meet this obligation.
- 7 Since the introduction of s912A(1)(h) in 2001, there have been a number of significant developments that highlight the importance of adequate risk management arrangements for responsible entities.
- 8 Based on our review of responsible entities' arrangements, we have also identified that there were inconsistencies in the arrangements between various responsible entities, particularly smaller responsible entities, and improvements could be made to some responsible entities' arrangements.

### Why is ASIC action needed?

- 9 In the absence of additional guidance we are concerned that some responsible entities may not have arrangements that are adequate to identify, assess and manage risks relevant to the business and schemes operated. Consumers may also suffer loss or adverse consequences if key risks are not adequately identified, assessed and managed by responsible entities.

### What policy options is ASIC considering?

- 10 We are considering the following options:
  - (a) *Option 1*—Issue additional guidance to responsible entities;
  - (b) *Option 2*—Issue a legislative instrument;
  - (c) *Option 3*—Issue joint guidance with the Australian Prudential Regulatory Authority (APRA); and
  - (d) *Option 4*—Maintain the status quo (i.e. rely on the current guidance in RG 104).

## What is the likely net benefit of each option?

- 11 We anticipate that:
- (a) Option 1 will provide the most balanced compromise of providing additional guidance to responsible entities with minimal increases in compliance costs, while also seeking to strengthen the protections afforded to consumers where appropriate;
  - (b) Option 2 is likely to result in significantly increased compliance costs for responsible entities, which are likely to be passed on to investors;
  - (c) Option 3 will only operate to assist responsible entities that are dual regulated and their investors and not the wider population of responsible entities and investors; and
  - (d) Option 4 may be detrimental, as it will result in inconsistent approaches by responsible entities to compliance and some risk management arrangements may not be adequate, with potential adverse impacts on investors.

## Who will ASIC consult about these options and how will ASIC consult them?

- 12 In March 2013, we published [Consultation Paper 204](#) *Risk management systems of responsible entities* (CP 204) and sought feedback on our proposals to introduce more targeted requirements for risk management of responsible entities.
- 13 In January 2016, we undertook informal consultation with APRA, a selection of 21 responsible entities and three industry bodies on our current proposals.
- 14 In July 2016, we released [Consultation Paper 263](#) *Risk management systems of responsible entities: Further proposals* (CP 263) seeking feedback on our current proposals and received five responses (including three from industry bodies). We subsequently undertook further informal consultation with industry bodies and a selection of responsible entities.

## What is the best option from those ASIC has considered?

- 15 The recommended option is Option 1, to issue additional guidance to responsible entities.

## How will ASIC implement and evaluate its chosen option?

- 16 The recommended option will be implemented by releasing a regulatory guide. The regulatory guide will be reviewed to consider industry and international developments on a regular basis.

## B Introduction

### Background

- 17 Under s912A(1)(h) of the Corporations Act, responsible entities as AFS licensees have an ongoing legal obligation to have adequate risk management systems. This obligation also applies to responsible entities that are dual-regulated entities. A dual-regulated entity is a registerable superannuation entity (RSE) licensee that also operates schemes.
- 18 RG 104 provides the only current guidance for AFS licensees (including responsible entities) about what we expect of them in meeting the obligation to have adequate risk management systems. This guidance is high level and generic, given the need for it to apply across all AFS licensees.
- 19 In March 2013, we published CP 204 to seek public feedback on our proposals to introduce targeted requirements and guidance to clarify responsible entities' ongoing obligation under s912A(1)(h) and to standardise the risk management practices across the managed funds industry.
- 20 Awaiting the outcome of the 2014 Financial System Inquiry process, we did not proceed to implement any of the proposals outlined in CP 204.

### Assessing the problem

#### Developments in the managed funds sector

- 21 There have been a number of significant developments in the managed funds sector that have highlighted the importance of having adequate risk management systems in place. These include:
- (a) an increase in the amount of assets managed. The funds management sector on an aggregated basis currently has more than \$1.5 trillion under management (including superannuation);
  - (b) growth in the number of schemes operated. There are now approximately 448 responsible entities and 3,619 registered schemes. In 2002, the number of registered schemes was approximately 1,806;
  - (c) a number of high-profile collapses of responsible entities where investors suffered losses. Some examples include Trio Capital, Allco Wholesale Investment Limited, Fincorp Financial Services Limited and LM Investments Limited. In relation to Trio Capital, for example, there was approximately \$125 million in losses with 6,048 investors impacted. Inadequate risk management arrangements inevitably played some role in these collapses;

- (d) diversification in the size, complexity and nature of the types of schemes managed by responsible entities. For example, there has been the introduction of new innovative schemes. In addition, a number of funds operate globally or with offshore investments, so there is a need to be responsive to international developments (e.g. the recent Brexit event);
- (e) the release of relevant international guidance and standards for risk management for managed funds and expectations for the regime of the local regulator. For example:
  - (i) the International Organization of Securities Commissions (IOSCO) publication *Principles of liquidity risk management for collective investment schemes: Final report* (IOSCO Principles); and
  - (ii) the recent Financial Stability Board (FSB) report, *Policy recommendations to address structural vulnerabilities from asset management activities* (FSB Recommendations); and
- (f) changing market conditions. Following the global financial crisis there has still been periods of significant market volatility and flow on impacts on liquidity and asset valuations. Approximately 250,000 retail investors were affected by the freezing of funds and unable to access more than \$20 billion of their money for a significant period.

### **Observations on the risk management systems of responsible entities**

- 22 We have undertaken proactive reviews of the risk management systems of responsible entities, some of which have been referred to publicly.
- 23 In 2011–12, we reviewed a cross section of responsible entities to assess the adequacy, and strategic and operational effectiveness, of their risk management systems and how they specifically manage financial, investment and liquidity risks. Our findings were published in [Report 298](#) *Adequacy of risk management systems of responsible entities* (REP 298).
- 24 More recently in February 2015, we surveyed 118 responsible entities to examine the adequacy of risk management and disclosure practices in the current environment. The survey was in response to increased volatility in global and domestic markets and referred to in [Media Release \(15-020MR\)](#) *ASIC enquires into risk management by responsible entities* (13 February 2015).
- 25 Based on our reviews, we identified that there were inconsistencies in the arrangements between various responsible entities, particularly smaller responsible entities. We also identified that improvements could be made to some responsible entities' arrangements to ensure they were robust enough to respond to relevant risks.

- 26 In particular we identified that:
- (a) some responsible entities relied heavily on disclosure as a tool to manage key risks;
  - (b) some responsible entities undertook stress testing while others did not;
  - (c) some responsible entities had limited resources and relied heavily on service providers for their risk management arrangements; and
  - (d) a number of responsible entities had not made any changes to their risk management systems following the global financial crisis to respond to market events.

## Why is ASIC action needed

- 27 In the absence of additional guidance, we are concerned that:
- (a) some responsible entities (particularly, smaller responsible entities) may not have arrangements that are adequate to identify, assess and manage relevant risks to the business and schemes operated;
  - (b) there will be no industry-wide standard that can assist responsible entities comply with this fundamental obligation; and
  - (c) consumers may suffer losses or adverse consequences if material risks are not adequately identified and managed by responsible entities.
- 28 Specifically, we are seeking to ensure that the risk management systems of all responsible entities:
- (a) include minimum procedures and practices; and
  - (b) are adaptable to changing market conditions and remain effective in identifying, assessing and managing risks on an ongoing basis.

## International guidance

- 29 As outlined above, there is relevant international guidance on risk management, such as the IOSCO Principles and the FSB Recommendations. This guidance sets out expectations for the regulator and also outlines tools for responsible entities to manage liquidity risk.
- 30 We have taken this international guidance into account in developing our proposals, and consider that our proposed guidance is consistent.
- 31 We consider that additional tailored local guidance is also required to establish minimum standards and to ensure that risk management systems of responsible entities are robust enough to respond to relevant risks. The



international guidance encourages local regulators to implement more specific guidance suitable for their own jurisdictions.

- 32 The key differences between the international guidance and our proposed guidance are:
- (a) our guidance is targeted at assisting responsible entities to understand what is required to meet their obligation under s912A(1)(h);
  - (b) while the international guidance focuses on liquidity risk of the scheme, our guidance is broader—it aims to help responsible entities comply with their obligation to manage all key risks at both the responsible entity and scheme level; and
  - (c) we have also outlined some additional expectations for managing liquidity risk—for example, having in place a liquidity management process and carrying out stress testing or scenario analysis at a minimum annually (or documenting why this is not appropriate) to assist responsible entities to manage this key risk. Based on feedback from our consultation process, we consider that this is consistent with industry practice in Australia.

## C Options and impact analysis

- 33 We consider that the options are:
- (a) *Option 1*—Issue additional guidance to responsible entities;
  - (b) *Option 2*—Issue a legislative instrument;
  - (c) *Option 3*—Issue joint guidance with APRA; and
  - (d) *Option 4*—Maintain the status quo (i.e. rely on the current guidance in RG 104).

### Option 1: Issue additional guidance to responsible entities (preferred option)

- 34 Under this option we propose to release a regulatory guide outlining guidance on risk management arrangements for responsible entities to comply with s912A(1)(h).
- 35 The proposed guidance does not impose new obligations on responsible entities but gives more detailed guidance on how they may comply with their current obligations under s912A(1)(h) to maintain adequate risk management systems.

#### Proposed regulatory guide

- 36 Our proposed guidance is intended for responsible entities, including dual-regulated entities. There are approximately 448 active responsible entities that will be impacted by the release of the guidance.
- 37 We also consider that the guidance is relevant to AFS licensees authorised to operate a scheme but not currently operating a scheme, investor directed portfolio services (IDPS) and managed discretionary account (MDA) operators, and entities operating unregistered managed investment schemes. There are approximately 35 IDPS operators, 64 MDA operators and 1,749 entities operating unregistered schemes.
- 38 The guidance outlines 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.
- 39 The guidance provides flexibility on how the above can be satisfied and enables responsible entities to take into account the nature, scale and complexity of the business and schemes operated. The guidance is based on our understanding of current industry practice and outlines the minimum standards expected.

40 We do not propose to have any formal transition period for the guidance as we are not imposing any new requirements on responsible entities. However, we consider it appropriate to take a facilitative approach to compliance for the initial 12-month period to assist those responsible entities working to bring their arrangements into compliance with the minimum standards.

### **Overarching risk management systems**

41 In terms of the overarching risk management systems, we expect responsible entities to establish and maintain risk management systems with documented processes to identify, assess and manage risks.

42 We also expect responsible entities to:

- (a) foster a strong risk management culture;
- (b) consider relevant industry, local and international standards;
- (c) have a liquidity risk management process;
- (d) review their risk management systems—to ensure that they are current, relevant, effective and complied with—as frequently as appropriate, given the nature, scale and complexity of the business and schemes operated (at a minimum, annually); and
- (e) if relying on external service providers, maintain a strong understanding of risk management and have sufficient skills to independently monitor and assess the performance and ongoing suitability of the service provider.

### **Processes for identifying and assessing risks**

43 In terms of identifying and assessing risks we expect responsible entities to:

- (a) have documented processes in place to identify and assess risks, including maintaining one or more risk registers;
- (b) ensure the systems implemented address all material risks at the responsible entity and scheme level—these include, but are not limited to, strategic risk, governance risk, operational risk, market and investment risk and liquidity risk; and
- (c) take into account factors outlined in the guidance when selecting processes for identifying and assessing risks.

### **Processes for managing risks**

44 In terms of managing risks our key expectations include that:

- (a) strategies are implemented for managing each of the risks identified, including a control monitoring and assurance process. We have outlined in the appendix to the guidance examples of key risks and strategies to manage these risks. For example, the use of liquidity management tools

such as suspension of redemptions, redemption gates or swing pricing to manage liquidity risks, when appropriate;

- (b) stress testing and scenario analysis in relation to liquidity risks is undertaken at least annually and more frequently as appropriate. If this is not conducted, we expect responsible entities to keep appropriate records of the reasons why and to review this decision regularly;
- (c) responsible entities comply with their other existing obligations as an AFS licensee. We consider these obligations are also relevant to managing risks—for example, having in place adequate financial and technological resources, compensation arrangements for retail clients and ensuring that significant breaches are identified and reported to ASIC within 10 business days; and
- (d) adequately experienced staff regularly review and monitor the risks identified.

### **Good practice guidance**

45 The regulatory guide also outlines good practice strategies that responsible entities may also consider adopting. This guidance is not mandatory but provides strategies for those responsible entities seeking to enhance their risk management systems above the minimum standards. We consider these strategies are more likely to be implemented by larger responsible entities and APRA regulated entities.

46 We consider that it is good practice for responsible entities to:

- (a) in establishing and maintaining risk management systems:
  - (i) conduct a comprehensive independent review of the appropriateness, effectiveness and adequacy of the risk management systems (at least every three years);
  - (ii) segregate functions to allow for independent checks and balances;
  - (iii) establish a designated risk management function and/or risk management committee;
  - (iv) appoint a chief risk officer; and
  - (v) publicly disclose appropriate details of the responsible entity's risk management systems;
- (b) in identifying and assessing risks, use risk indicators and regularly report on these; and
- (c) in managing risks:
  - (i) conduct regular stress testing and scenario analysis of all material risks to the responsible entity's business and schemes it operates;
  - (ii) have a written plan for treating risks; and

- (iii) include in the compliance plan procedures for ensuring that the material risks identified for the responsible entity and relevant schemes are managed on an ongoing basis.

#### **Key differences to prior CP 204**

- 47 The proposed regulatory guide is based on the guidance outlined in CP 204. The key differences to the approach we outlined in CP 204 are:
- (a) not introducing a legislative instrument imposing more prescriptive requirements;
  - (b) making the requirements more consistent with the APRA requirements, where appropriate;
  - (c) including references to international guidance where appropriate; and
  - (d) providing some additional guidance in the regulatory guide and appendix on relevant risks and risk management strategies (e.g. cyber resilience, fraud risk and liquidity risk).

#### **Impact on industry**

- 48 Based on feedback from industry we anticipate there will be some increase in compliance costs for responsible entities, particularly smaller responsible entities. Responsible entities will need to review the regulatory guidance and their current arrangements, to assess whether any changes are required and to implement any changes. We estimate that these initial costs will be in the range of \$10,454 to \$14,454 for a responsible entity.
- 49 There will also be compliance costs associated with review of the risk management systems (which should occur, at a minimum, annually). We estimate that these ongoing costs will be \$1,473 each review for a responsible entity.
- 50 While we have based our estimates on the entire population of responsible entities, we note that the relevant costs and savings incurred will vary for each responsible entity depending on the nature, scale and complexity of the business and scheme(s) operated and the current risk management arrangements implemented. We consider that a number of responsible entities will already have arrangements that meet the expectations outlined in the proposed guidance or are operating at a standard above the expectations.
- 51 We do not anticipate this option will have any impact on competition, given:
- (a) that the existing obligation under s912A(1)(h) applies to all responsible entities;
  - (b) that the guidance will also apply to all responsible entities; and
  - (c) the amount of the estimated compliance costs involved.

52 We consider that the compliance costs will be offset by the benefits industry will receive from additional clarity on what is required to comply with their existing obligation under s912A(1)(h) and the introduction of minimum standards that apply to all responsible entities.

### **Impact on consumers**

53 We consider consumers will benefit from the proposed guidance as it provides a better understanding of minimum standards that responsible entities are expected to comply with. In addition, the guidance is aimed at assisting in the early identification of risks and management of risks by responsible entities and to avoid the adverse consequences that may otherwise flow to investors.

54 We anticipate that the above benefits will outweigh any additional compliance costs that may be passed on to investors.

## **Option 2: Issue a legislative instrument**

55 We considered adopting the approach previously outlined under CP 204 to modify s912A(1)(h) by legislative instrument to include more targeted requirements for risk management systems of responsible entities.

56 This option would result in stronger enforcement consequences, as the requirements would be imposed as additional legislative obligations that mandate particular conduct.

57 Based on feedback received from industry we did not consider that this approach was appropriate. Risk management is an area where there are a number of ways that the requirements could be met depending on the nature, scale and complexity of the particular business and scheme operated. We consider flexibility is required to accommodate this and to enable responsible entities to respond to any changes in market conditions and industry practice.

58 In addition, the introduction of prescriptive requirements would impose significant compliance costs, particularly for smaller operators, which we did not consider were proportionate to the regulatory benefit we would achieve.

### **Impact on industry**

59 Based on our consultation with industry on CP 204, which occurred three years ago, the additional cost of compliance with the targeted requirements was estimated to be \$25,000–\$35,000 per year for a responsible entity. In addition, industry have raised concerns during each consultation undertaken that mandated requirements are not appropriate for risk management.

### **Impact on consumers**

- 60 We would expect that some responsible entities would ultimately pass on the significant additional compliance costs to investors.

## **Option 3: Issue joint guidance with APRA**

- 61 We considered the option of releasing joint guidance with APRA. This option would assist entities that are dual regulated as it would consolidate all relevant guidance on risk management.
- 62 We do not consider this option is preferable. Dual-regulated entities represent a small proportion of responsible entities and the guidance needs to be appropriate for all responsible entities. There are approximately 20 dual-regulated entities out of the 448 active responsible entities. In addition, APRA's focus is on prudential regulation. We are concerned to ensure that the guidance addresses our wider regulation of responsible entity conduct and risk management arrangements at both the responsible entity and scheme level.
- 63 We have, however, consulted with APRA in developing our proposed guidance to seek feedback and to ensure consistency with current APRA guidance.

### **Impact on industry**

- 64 While this option would assist dual-regulated entities, we consider that the guidance under this option would not be sufficiently tailored to assist the broader population of responsible entities that are not dual regulated. As a result it would not address the current problem for all responsible entities that there is no tailored guidance.
- 65 We estimate that the costs of this option would be the same as Option 1 for dual-regulated entities, as we would propose the same requirements to be included in the joint guidance.

### **Impact on consumers**

- 66 This option may assist investors in schemes operated by dual-regulated entities, as they may benefit from any additional protections and minimum standards that could be developed in the guidance, but would not assist investors in schemes operated by other responsible entities. Dual-regulated entities may pass on any additional compliance costs to investors.

## Option 4: Maintain the status quo

- 67 We also considered the option of maintaining the status quo (i.e. relying on the limited guidance under RG 104).
- 68 This approach would require industry to determine how to comply with the obligation with limited guidance. As previously outlined, we consider that this may have led to some inconsistencies in approaches by some responsible entities.
- 69 We have also not observed any industry initiatives to address this issue and remove the need for additional guidance. There is currently no single or combination of industry bodies that represents the wide variety of responsible entities that could draft, secure industry support for, implement and monitor compliance with a code or set of standards.

### Impact on industry

- 70 Industry would still have uncertainty on what is required to comply with s912A(1)(h) and may adopt inconsistent approaches. Responsible entities may continue to incur compliance costs (e.g. advice from legal representatives or consultants, review by internal staff to determine what is required to comply, and costs associated with rectification of risks that are not adequately identified, assessed and managed).

### Impact on consumers

- 71 Investors would not benefit from any additional consumer protection and the current arrangements implemented by some responsible entities may not be adequate to respond to relevant risks. Any compliance costs incurred by responsible entities in determining what is required to comply with s912A(1)(h) may be passed on to investors.



## D Consultation

### Release of CP 204 and feedback received

- 72 As previously outlined, in March 2013 we published CP 204, which sought feedback on proposals to introduce more targeted requirements for risk management systems of responsible entities.
- 73 We received five submissions in response to CP 204, including submissions from two industry bodies.
- 74 Generally, respondents supported the need for specific guidance on the risk management systems of responsible entities. Feedback indicated that most of the proposed processes were already included in the existing risk management systems of a number of responsible entities, to varying degrees of sophistication.
- 75 The main concern raised by industry related to the proposed ASIC instrument. The feedback outlined that an instrument may be appropriate if it was necessary to modify the law and exempt responsible entities from the law (albeit on conditions), but it seemed unnecessary and not appropriate to use an instrument to record our guidance and expectations. Based on the estimate from one responsible entity, the additional cost of compliance with the targeted requirements would be \$25,000 to \$35,000 per year.
- 76 Other key issues raised in the feedback were that:
- (a) the responsible entity should be given the flexibility to implement this guidance appropriate to the nature, scale and complexity of the responsible entity's operations. In addition, the guidance should expressly recognise the ability of a responsible entity within a group of entities to leverage group compliance and risk frameworks;
  - (b) there was a need for clarification of whether the requirements should also apply to unregistered schemes;
  - (c) there was a need for alignment of the proposed requirements with APRA requirements; and
  - (d) there was a need for a transition period.
- 77 We have addressed each of these issues in the proposed guidance where appropriate.

## Informal consultation on proposals

- 78 In January 2016, we consulted with APRA, a selection of 21 responsible entities (which included large and small responsible entities) and three industry bodies.
- 79 APRA provided feedback that nothing in the proposed guidance appeared inconsistent with APRA's requirements.
- 80 We received the following feedback from industry:
- (a) There was support for further guidance to assist in consistency across the industry.
  - (b) Any guidance should be principles based and flexible, to accommodate the size, nature and complexity of the responsible entity's business.
  - (c) A number of responsible entities are generally complying with most, if not all, of the proposed requirements. Smaller standalone responsible entities are anticipated to be the most impacted and may have some costs with engaging expertise or embedding the arrangements.
  - (d) There should be no duplication or inconsistencies with existing obligations.
  - (e) The proposed good practice guidance could potentially add regulatory burden and it was unclear whether it was mandatory.
  - (f) A legislative instrument was not appropriate for the reasons outlined in response to CP 204.
  - (g) A transition period should be implemented.
  - (h) Responsible entities should be invited to provide feedback on the proposed guidance.
- 81 We took on board the above feedback and have taken steps to address issues raised where appropriate.

## Release of CP 263 and feedback received

- 82 We released CP 263 in July 2016 seeking feedback on our proposals and received five responses (including three from industry bodies).

### Feedback on expectations outlined in the guidance

- 83 In summary, we received the following feedback on the expectations outlined in the guidance:
- (a) Industry was broadly supportive of the release of additional guidance and the guidance was considered to be helpful.

- (b) There were differing views on what transition period would be appropriate. Some feedback has been that a six-month formal transition period would be appropriate, while other feedback considered that an 18-month interim period would assist smaller operators. On the information provided, we consider the 12-month facilitative approach to compliance remains appropriate and that a formal transition period is not appropriate, given there is no change to the existing obligation to comply with s912A(1)(h).
- (c) One respondent thought further guidance on how the expectations apply to the responsible entity for hire business model would be helpful. As the guidance applies to all responsible entities, we do not propose to focus on particular business models. The existing guidance outlines that, consistent with s601FB, the responsible entity is responsible for the operation of the scheme and compliance with its obligations;
- (d) Two respondents thought the expectation for stress testing at the business level appeared unnecessary and may not generally be undertaken by industry currently. We propose to amend the guidance to reflect our expectation that stress testing of liquidity be done at the scheme level.
- (e) One respondent considered that it was onerous to assess and maintain a risk register for the risks of each scheme. We acknowledge that there may be common risks that apply across schemes operated, and in the existing guidance we have provided flexibility for the risks to be documented in one or more registers (rather than a requirement to have separate registers for each scheme). However, we consider it important that the risk management systems implemented address the material risks of the responsible entity and each scheme operated.
- (f) One respondent considered that it was onerous for responsible entities to have to take into account relevant industry, local and international standards. We propose to clarify 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.

### **Feedback on good practice guidance**

84 We received feedback that there are challenges to implementing some aspects of the good practice guidance, in particular:

- (a) the requirement to include content in the compliance plan, which may require amendments to compliance plans and go beyond and confuse the content of compliance plans that is prescribed at law and 'supplemented by' [Regulatory Guide 132 \*Managed investments: Compliance plans\*](#) (RG 132). We propose to amend the guidance to clarify that our recommendation supplements the existing legislative

and policy requirements for compliance plans and that any update of the compliance plan for existing schemes may be considered as part of a broader review or update;

- (b) the requirement to release publicly details of the risk management policies did not appear to add value or assist investors and there were issues of commercial sensitivity. We propose to clarify that our recommendation is that a summary of the key aspects of the risk management systems be disclosed publicly. We consider this information will help ensure investors are informed of the risk management arrangements in place and we also received feedback that supported the requirement. We do not propose to impose this as a mandatory requirement in light of the concerns raised in feedback received;
- (c) it was unclear what a written risk treatment plan was. We propose to include additional guidance on the role and recommended content of the plan;
- (d) that the dedicated risk officer should also be able to have other roles. We do not propose to facilitate this as the segregation of the role is intended to assist to manage any conflicts and the guidance is not mandatory; and
- (e) that to conduct stress testing or scenario analysis of all material risks would require sophistication of programs across industry and appropriate transition period should be considered. As this guidance is not mandatory we do not propose to facilitate any transition period.

85 It was also identified by one respondent that the good practice guidance included an incorrect statement 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. We propose to delete this reference.

86 We received feedback from one respondent that it should be mandatory, rather than good practice guidance, to carry out a comprehensive review of the appropriateness, effectiveness and adequacy of the risk management systems at least every three years. We do not propose to impose this 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 a minimum annually) outlined in the guidance.

87 In December 2016 and January 2017 we undertook additional consultation with industry bodies and a selection of responsible entities. This follow-up

consultation sought further information on costs and the impacts of our proposals.

- 88 Copies of CP 263 and of our [Report 517](#) *Response to submissions on CP 263 Risk management systems of responsible entities* (REP 517) are available from the ASIC website.

## E Conclusion and recommended option

- 89 Having assessed the options available and the net benefit of each option, we recommend Option 1, the issue of additional guidance for responsible entities.
- 90 There is currently no detailed guidance to responsible entities on what is required to comply with their existing obligation under s912A(1)(h).
- 91 We consider Option 1 will help responsible entities understand what is required to comply with s912A(1)(h) while allowing flexibility for arrangements to be tailored to the nature, scale and complexity of their operations. Further, based on our consultation, industry is broadly supportive of Option 1 and considers the additional guidance would be helpful.
- 92 We also consider Option 1 will help consumers. The guidance promotes the early identification and management of risks by responsible entities to help avoid the adverse consequences that may affect investors. There have been a number of collapses of responsible entities that resulted in significant losses to investors and where we consider inadequate risk management systems played a role. We consider the introduction of minimum standards for all responsible entities will assist to enhance risk management systems and assist consumer protection.

## F Implementation and review

- 93 In developing this RIS we have undertaken the following steps to implement the proposals:
- (a) submitted a Preliminary Assessment Form to Office of Best Practice Regulation (OBPR). OBPR confirmed a RIS was required;
  - (b) consulted on the options and sought preliminary feedback from OBPR on our consultation and the initial RIS we prepared; and
  - (c) submitted the RIS to OPBR for final assessment.
- 94 The recommended option will be implemented by release of [Regulatory Guide 259](#) *Risk management systems of responsible entities* (RG 259).
- 95 RG 259 will be reviewed to consider industry and international developments on a regular basis.
- 96 During the initial 12-month period from release of the regulatory guide we propose to undertake a facilitative approach to compliance. At the end of this period, we propose to undertake a review of responsible entities' compliance with the regulatory guide.

## G Regulatory Burden and Cost Offset (RBCO) Estimate Table

- 97 The estimated costs (and cost savings) of Option 1 are outlined in Table 1– Table 3. These are calculated as a difference from business as usual.
- 98 The estimated costs of Option 2 are \$25,000 to \$35,000 a year for a responsible entity. The costs are outlined in Table 4.
- 99 The estimated costs of Option 3 are the same as the costs of Option 1 for the 20 dual-regulated entities. This is a total initial cost of \$10,454 to \$14,454 and \$1,473 each year for ongoing review. The costs are outlined in Table 5.
- 100 Under Option 4 we would be maintaining the status quo, so there are no additional compliance costs that would be imposed. Responsible entities would not benefit from the cost savings that result from Option 1.

### Option 1

**Table 1: Average estimated initial and ongoing compliance costs (Option 1)**

Cost type	Cost per entity	Total cost to sector
Review of guidance and current risk management arrangements (one off)	An initial cost of <b>\$4,454</b>  Note: This includes 5 days of a staff member's time to review the guidance and existing arrangements, assuming an hourly rate of \$65.45 and a 7.5 hour day. It also includes an estimate of \$2,000 for any other reviews considered necessary, such as by senior management or the board.	<b>\$2.0m</b> (\$4,454 multiplied by 448 responsible entities)
Revisions to existing risk management arrangements (one off)	An initial cost of <b>\$6,000 to \$10,000</b>  Note: These costs relate to the introduction of any documented systems and revisions to processes to identify, assess and manage risks. The costs include the work of internal staff and any external service providers engaged to assist the responsible entity.	A range of <b>\$2.7m</b> (\$6,000 multiplied by 448 responsible entities) to <b>\$4.5m</b> (\$10,000 multiplied by 448 responsible entities)
Total initial costs incurred over 10-year period	A range of <b>\$10,454</b> (\$4,454 plus \$6,000) to <b>\$14,454</b> (\$4,454 plus \$10,000)	A range of <b>\$4.7m</b> (\$2m plus \$2.7m) to <b>\$6.5m</b> (\$2m plus \$4.5m)
Average annual impact for one-off costs	<b>\$1,045</b> (\$10,454 divided by 10 years) to <b>\$1,445</b> (\$14,454 divided by 10 years)	A range of <b>\$470,000</b> (\$4.7m divided by 10 years) to <b>\$650,000</b> (\$6.5m divided by 10 years)
Regular review of risk management arrangements (at a minimum annually)	An ongoing cost of <b>\$1,473</b> each year  Note: Based on 3 days of a staff member's time to review the existing arrangements assuming an hourly rate of \$65.45 and a 7.5 hour day.	<b>\$659,904</b> (\$1,473 multiplied by 448 responsible entities) each year



Cost type	Cost per entity	Total cost to sector
Total annual costs	A range of <b>\$2,518</b> (\$1,473 plus \$1,045) to <b>\$2,918</b> (\$1,473 plus \$1,445) each year	A range of <b>\$1.1m</b> (\$659,904 plus \$470,000) to <b>\$1.3m</b> (\$659,904 plus \$650,000) each year

Note 1: Number of responsible entities based on the 448 active responsible entities listed in the *ASIC Annual Report 2015–16*.

Note 2: While we have based our estimates on the entire population of responsible entities, we note that the relevant costs and savings incurred will vary for each responsible entity depending on the nature, scale and complexity of the business and scheme(s) operated and the current risk management arrangements implemented. We consider that a number of responsible entities will already have arrangements that meet the expectations outlined in the proposed guidance or are operating at a standard above the expectations.

**Table 2: Average estimated compliance cost savings (Option 1)**

**Cost savings for new AFS licence applicants**

Saving type	Savings per entity	Total savings to sector
Reduced time spent preparing risk management proofs in connection with obtaining an AFS licence for new responsible entities  Note: Estimated to be 20 applicants	An initial saving of <b>\$982</b>  Note: Based on 2 days of a staff member's time to review the existing arrangements assuming an hourly rate of \$65.45 and a 7.5 hour day.	<b>\$19,640</b> (\$982 multiplied by 20 applicants)
Reduced costs of obtaining expert advice from a consultant or legal adviser on what is required to comply with s912A(1)(h)	A range of <b>\$1,250</b> (5 hours of advice at \$250 an hour) to <b>\$2,500</b> (10 hours of advice at \$250 an hour)	A range of <b>\$25,000</b> (\$1250 multiplied by 20 applicants) to <b>\$50,000</b> (\$2,500 multiplied by 20 applicants)
Total annual savings in connection with AFS licence process for new responsible entities	A range of <b>\$2,232</b> (\$982 plus \$1,250) to <b>\$3,482</b> (\$982 plus \$2500)	A range of <b>\$44,640</b> (\$19,640 plus \$25,000) to <b>\$69,640</b> (\$19,640 plus \$50,000)

Note: Number of applicants based on estimated slight increase of 18 applications from new responsible entities we received in the 2015–16 financial year.

**Cost savings for established responsible entities**

Saving type	Savings per entity	Total savings to sector
Reduced time in responding to risks that are not adequately, identified, assessed and managed	An ongoing saving of <b>\$1,964</b> each year  Note: Based on 4 days of a staff member's time to respond to the risk assuming an hourly rate of \$65.45 and a 7.5 hour day	<b>\$879,872</b> (\$1,964 multiplied by 448 responsible entities) each year
Reduced costs of responding to serious impacts of risks that are not adequately identified, assessed and managed  Note: Estimated to affect 1% of responsible entities (or 4.5 entities)	A range of <b>\$25,000</b> to <b>\$100,000</b>  Note: Includes any costs of rectification.	A range of <b>\$112,500</b> (\$25,000 multiplied by 4.5 responsible entities) to <b>\$450,000</b> (\$100,000 multiplied by 4.5 responsible entities)

Saving type	Savings per entity	Total savings to sector
Total annual savings for established responsible entities	A range of <b>\$26,964</b> (\$1,964 plus \$25,000) to <b>\$101,964</b> (\$1,964 plus \$100,000)	A range of <b>\$992,372</b> (\$879,872 plus \$112,500) to <b>\$1.3m</b> (\$879,872 plus \$450,000)

Note: Number of responsible entities based on the 448 active responsible entities listed in the *ASIC Annual Report 2015–16*.

### Total annual savings

Saving type	Savings per entity	Total savings to sector
<b>Total annual savings</b>	<b>\$29,196</b> (\$2,232 plus \$26,964) to <b>\$105,446</b> (\$3,482 plus \$101,964)	A range of <b>\$1.04m</b> (\$44,640 plus \$992,372) to <b>\$1.4m</b> (\$69,640 plus \$1.3m)

Note 1: While we have based our estimates on the entire population of responsible entities, we note that the relevant costs and savings incurred will vary for each responsible entity depending on the nature, scale and complexity of the business and scheme(s) operated and the current risk management arrangements implemented. We consider that a number of responsible entities will already have arrangements that meet the expectations outlined in the proposed guidance or are operating at a standard above the expectations.

Note 2: The savings per entity total is not reflective of savings for each of the 448 active responsible entities as some of the savings will only apply to a sector of responsible entities.

**Table 3: Average annual regulatory costs (Option 1)**

Category	Business	Community organisations	Individuals	Total
Total change in costs, by sector	A range of \$1.1m to \$1.3m	N/A	N/A	A range of <b>\$1.1m</b> to <b>\$1.3m</b>
Cost offset	A range of \$1.04m to \$1.4m	N/A	N/A	A range of <b>\$1.04m</b> to <b>\$1.4m</b>
Agency	N/A	N/A	N/A	N/A

Note 1: See Table 1 for details of the change in costs.

Note 2: See Table 2 for details of the cost offsets.

<b>Are all new costs offset?</b>	Yes
<b>Total (change in costs minus cost offset)</b>	<b>\$60,000 to \$260,000</b>
<b>Has the cost impact been warranted?</b>	Yes

## Option 2

**Table 4: Average annual regulatory costs (Option 2)**

Category	Business	Community organisations	Individuals	Total
Total change in costs, by sector	A range of \$11.2m to \$15.7m	N/A	N/A	A range of <b>\$11.2m</b> to <b>\$15.7m</b>

Category	Business	Community organisations	Individuals	Total
Cost offset	A range of \$1.04m to \$1.4m	N/A	N/A	A range of <b>\$1.04m to \$1.4m</b>
Agency	N/A	N/A	N/A	N/A

Note 1: The change in costs are based on estimated cost impact of \$25,000 to \$35,000 multiplied by 448 responsible entities.

Note 2: The cost offsets are estimated to be the same as Option 1.

## Option 3

**Table 5: Average annual regulatory costs (Option 3)**

Category	Business	Community organisations	Individuals	Total
Total change in costs, by sector	A range of \$50,368 to \$58,368	N/A	N/A	A range of <b>\$50,368 to \$58,368</b>
Cost offset	\$0	N/A	N/A	\$0
Agency	N/A	N/A	N/A	N/A

Note 1: The change in costs are based on estimated cost impact of Option 1 multiplied by the estimated 20 responsible entities impacted.

Note 2: As the relevant responsible entities are dual regulated and currently subject to APRA's requirements, it is difficult to estimate any relevant cost savings that would flow.