Building on the past, seeking the future

Risk and Compliance Benchmarking Survey 2014

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Foreword

This year represents the seventh year in which we have surveyed Australia's leading Fund Managers and Superannuation Funds about their Risk and Compliance practices, their views on the industry and the Regulators' area of focus. Respondents have told us that the risk and compliance landscape continues to evolve as a consequence of industry change. Whether these changes are a result of market volatility, political change, regulator enforcement or just the natural challenge of the status quo, Risk and Compliance functions have been driven to adapt.

Respondents were consistent in detailing what they believe will continue to impact the industry.

Firstly, regulation will continue to dominate but, potentially in a new and different way. Since the Global Financial Crisis the industry has experienced and dealt with a significant amount of regulatory change. We have heard that respondents are keeping a keen eye on the developments from the Government's broader deregulation agenda as a means of reducing the burden. This has already been seen through the proposed changes to the Future of Financial Advice (FoFA) requirements enacted under the previous Government and is likely to continue as an outcome of the inquiry into Australia's financial system (Murray Inquiry).

Secondly, the aftermath of the Senate inquiry into the performance of the Australian Securities and Investments Commission (ASIC) is expected to bring change. Not necessarily through legislation, but rather through heightened expectations of how organisations govern and manage risk and compliance as well as how ASIC will engage the market and enforce the law.

In addition to addressing local challenges, risk and compliance professionals are being asked to remain cognisant of the global regulatory and leading practices landscapes to see how it will influence the Australian market. To that point, we have included insights from this year's PwC State of Compliance survey conducted in the United States which focuses on the role of the Chief Compliance Officer.

Nicole Salimbeni

Partner, Risk Consulting

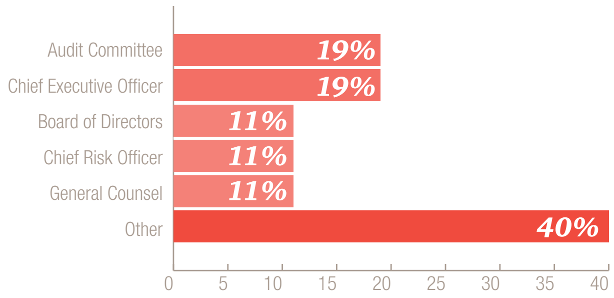
We appreciate the continued support of the survey respondents. Your participation and openness is essential in maintaining the survey's relevance and providing meaningful insights for risk and compliance professionals and their key stakeholders.

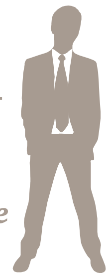
2 Highlights

We had 43 responses to this year's survey. The results provide an overview of the current landscape and highlight the challenges faced by Risk and Compliance functions. Key survey findings include:

37% have a separate risk function and compliance function.

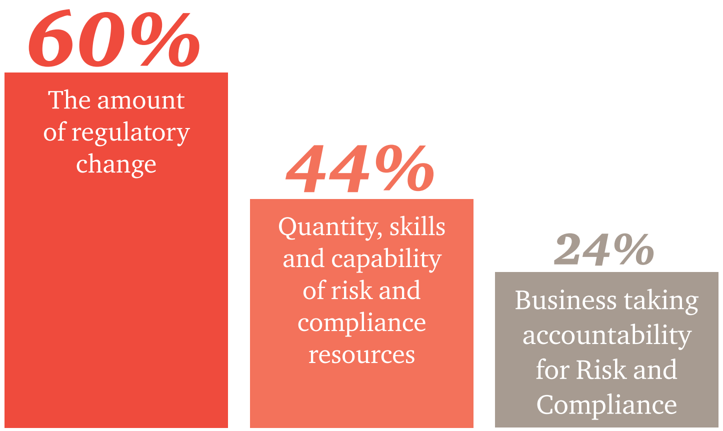
The reporting lines for the risk and compliance officer



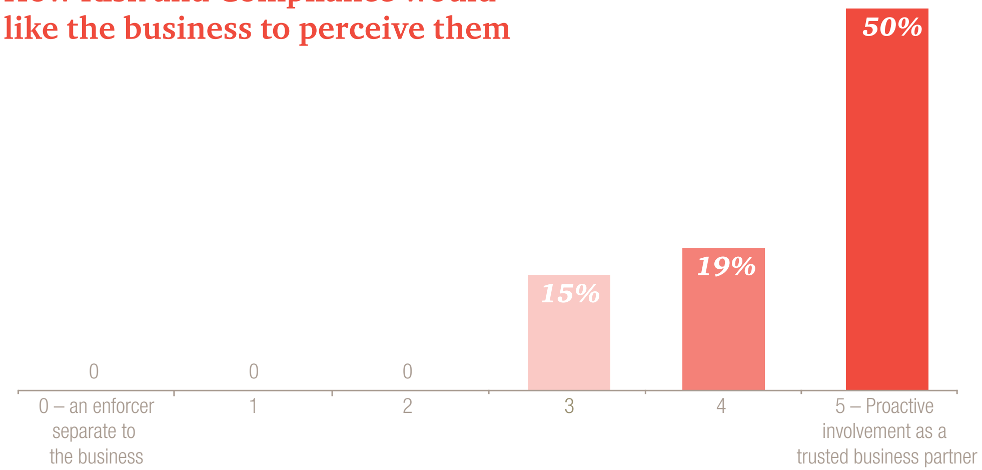


***45%** indicate that those with the most responsibility for compliance wear multiple hats.*

Key challenges faced by Risk and Compliance functions



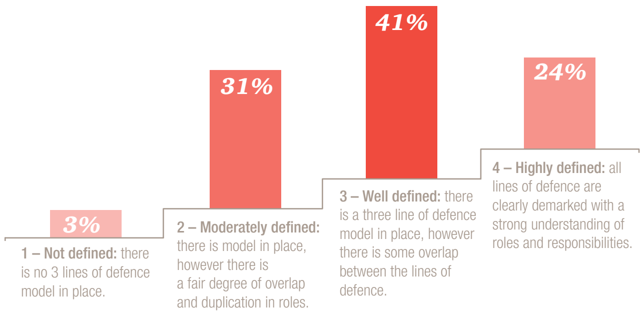
How Risk and Compliance would like the business to perceive them



The outsourcing trend continues

15% have outsourced part(s) of their business to an overseas service provider in the past 12 months.

The Lines of Defence is the preferred model to govern and manage risk



100%

use business attestations to manage compliance. 79% suggested they verify the results.

54% *of organisations had at least one complaint escalated to the Superannuation Complaints Tribunal (SCT) or the Financial Ombudsman Services (FOS). This is a large jump from last year where only 9% or organisations had one or more complaints escalated.*

42% of respondents indicate that they monitor social media for complaints, compared to ***23%*** in 2012.

Complaints this year mostly centred around:

- Client dissatisfaction with customer service
- Account maintenance
- Fund performance

71% of organisations noted that the majority of breaches are identified by the Business.

38% reported one or more breaches to the regulator.

An Industry under review

Since the Inquiry into the Australian financial system in 1997 (Wallis Inquiry) which laid many of the principles on which the current legislation is based, the financial services industry has been placed under a continual state of scrutiny. Significant market events and the behaviour of industry participants have led to an increase in targeted inquiries as a means to assess and drive industry change:

Super System Review – looking into the governance, efficiency, structure and operation of Australia's superannuation system. This paved the way for a surge of legislation that was said, if fully implemented, could lower superannuation fees by 40 per cent. However, recent evidence shows Australians are still paying fees which are almost three times that of the United Kingdom.

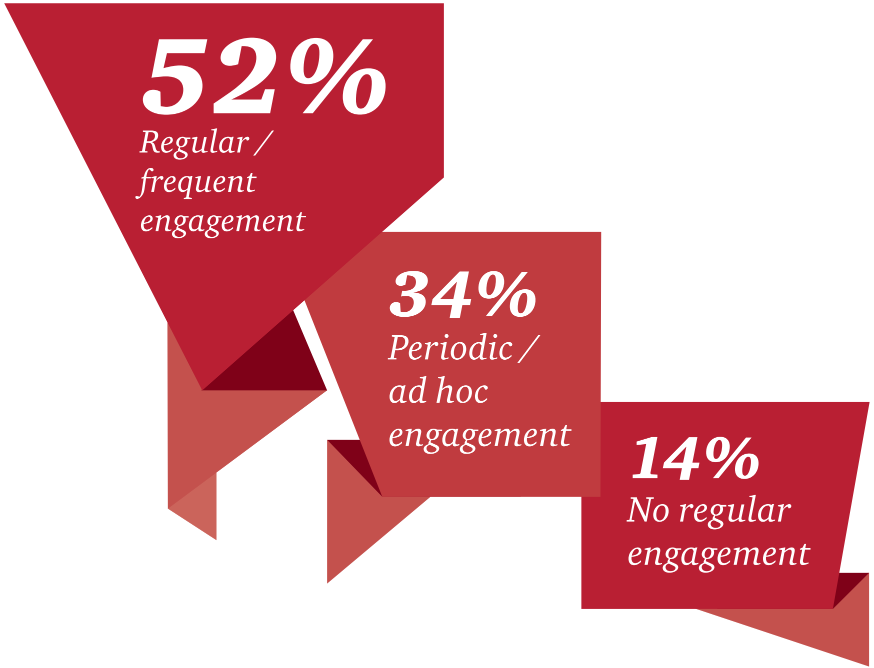
Ripoll Inquiry – looking into the financial products and services in Australia. The outcomes of this Inquiry, Future of Financial Advice (FoFA) reforms, remain highly contested twelve months since their inception with the current government looking to make further amendments.

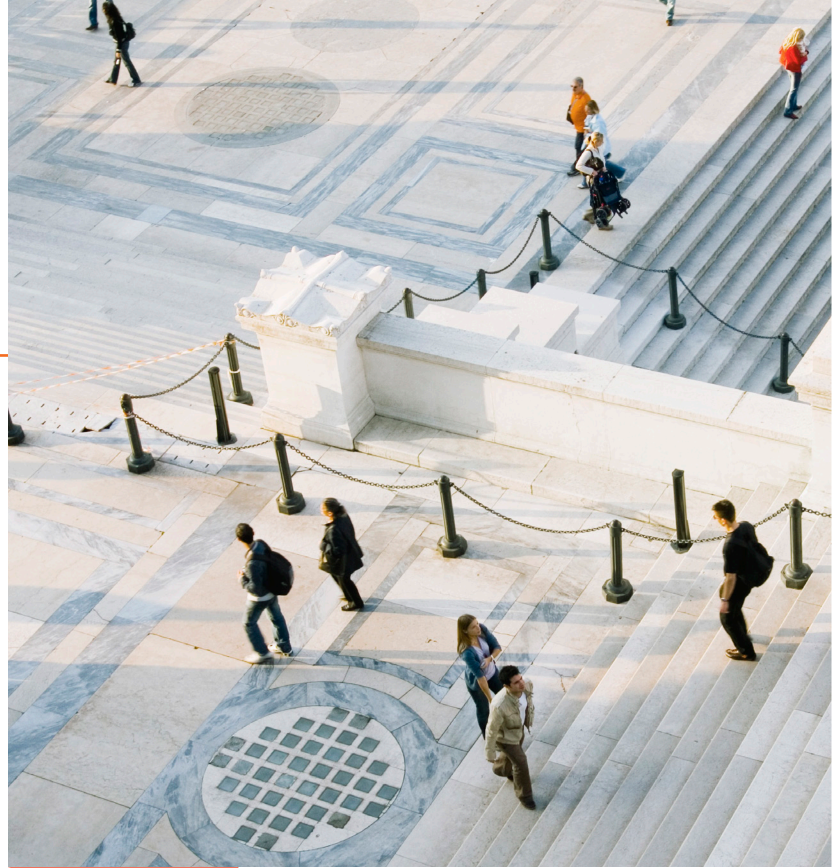
Murray Inquiry – charged with examining how Australia's financial system could be positioned to best meet Australia's evolving needs and support Australia's economic growth. The interim report released in July 2014 has set the scene for further change to the financial services industry.

This continual scrutiny means Risk and Compliance functions continue to be tested to provide the necessary support to manage the risk and compliance obligations of today, while providing insight and foresight needed to shape and respond to tomorrow.

3 Regulator engagement

The results of this year's survey have shown many organisations are adopting a proactive approach in how they engage Regulators.

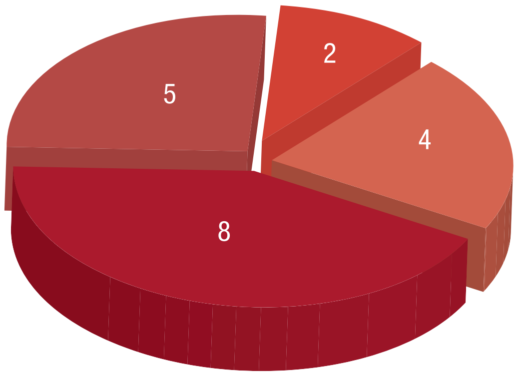




Notwithstanding the difference in size and complexity of this year's respondents, we believe there are benefits in taking a proactive approach when engaging the Regulator including:

- Insights into the thoughts and areas of focus. This can relate to industry wide related topics or specific challenges that your organisation is dealing with on a day-to-day basis
- The ability to share your experiences and promote key risk and compliance initiatives
- Raise and obtain perspectives on specific concerns currently being dealt with by the business.

In this year's survey, 53% of respondents indicated they had a Regulator visit during the period. This was spread across the following Regulators:



Instances were reported where an organisation was subject to multiple engagements from separate regulators.

This can be for a number of reasons, including as part of the Regulators' proactive monitoring and supervision or in response to a reported breach or complaint. Recent events, focus and activity from ASIC and the Australian Prudential Regulatory Authority (APRA) have caused many organisations within the Funds Management and Superannuation industries to re-visit and formalise their Regulator engagement models and strategies to outline:

- The primary Regulators relevant to the organisation that a proactive relationship is desired
- Who within the organisation is responsible for building and maintaining the relationship with the Regulators
- The desired frequency of engagement relevant to the level of seniority
- How information, feedback and insights are to be reported back to the organisation.

3

Breaches as a driver of regulator engagement

Many still question whether reporting a breach will drive Regulator action. As part of this year's analysis we have sought to identify any potential correlation between the number of breaches reported and the number of Regulator initiated visits.

1717 *Total number of breaches identified across all respondents*

38% *Reported one or more breaches, of which*

27%
reported they were subject to a Regulator visit from either ASIC or APRA during the period. This results suggests little correlation between the breaches reported and the number of Regulator visits, and is also supported by anecdotal evidence which suggests that the more open and transparent an organisation is with the Regulator the greater the ability of that organisation to form a trusted working relationship with the Regulator.

3

Future regulator engagement remains uncertain

Following the results of the Senate inquiry and recent budgetary cuts announced, particularly to ASIC, Regulators are likely to make a monumental shift in focus and approach.

ASIC Chairman Greg Medcraft has already suggested "proactive surveillance will substantially reduce across the sector we regulate and in some cases it will stop." ASIC are yet to release to the market exactly how this will affect the way they operate, however, we understand the following are being considered as potential outcomes:

- moving towards a "user-pays" regulator model
- greater reliance on self-regulation and auditors to identify and report instances of misconduct
- reduced tolerance for lengthy engagement relating to instances of non-compliance.

Despite the outcomes, it is expected the nature and extent of industry engagement will be targeted. This places greater importance on establishing a strategic approach where organisations can drive and better manage their Regulator engagement.

4 People and capability

65% of respondents would like the Risk and Compliance function to be a trusted business partner.

The message is consistent, 65% of respondents would like the Risk and Compliance function to be a trusted business partner. The challenge is how to attract and retain the right people for these roles.

Risk and Compliance wears multiple hats

A common theme from this year's survey is that Risk and Compliance roles are not dedicated roles, with respondents indicating that 45% of individuals with the most responsibility for Risk and Compliance wear multiple hats. Therefore, the ability for these individuals to dedicate the right level of time and attention to their Risk and Compliance role is a challenge and potentially heightens the organisation's risk.

A contrasting statistic to the above is that 37% of respondents reported they have separate Risk and Compliance teams. While there is no right or wrong answer to whether Risk and Compliance teams should be separate or together, there is a clear need for collaboration and connectivity between the two – applying a common vocabulary, approach and preferably, technology solutions to Risk and Compliance processes.

62% have been required to up-skill or recruit for new skills and capabilities as a result of the regulatory change agenda.

4

Having the right team

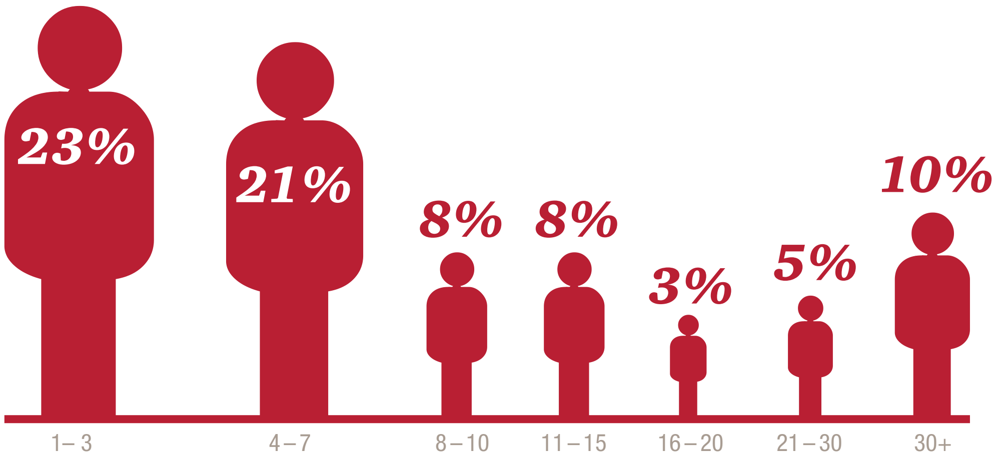
The difficulty in finding individuals with the right Risk and Compliance skills, experience, industry knowledge and regulatory understanding is a prevailing theme year-on-year. We have also noted little movement in the size of Risk and Compliance teams, with 44% of respondents reporting to have between 1 to 7 Risk and Compliance members working within the central ("Line 2") function.

The top two challenges faced by this year's respondents were:

- Regulatory change (60%)
- Quantity, skills and capability of risk and compliance resources (44%).

While they may present different challenges, they are not mutually exclusive. The volume and speed of regulatory change impacting the Funds Management and the Superannuation industry over the past five years has placed the Risk and Compliance function in a precarious position. Organisations are calling on Risk and Compliance to continually support the business in embedding recent changes, whist retaining sufficient capacity and expertise to support compliance, enhance risk and compliance processes and provide the necessary insight and foresight of the risks of future change.

Size of risk and compliance teams



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These challenges represent both ends of a Risk and Compliance mandate and require specific skills and competencies to achieve the necessary balance. Therefore, when it comes to the desired skills and competencies sought by organisations, respondents indicated having risk and compliance, regulator and commercial or operational experience as the top three desired attributes.

This result suggests organisations are looking for Risk and Compliance professionals that are commercially savvy and can engage the business on cross-functional issues, rather than a typical audit approach.

Another factor to consider when determining the desired skills and competencies of a Risk and Compliance professional is how the organisation structures itself to govern and manage risk. 97% of respondents suggested they operate, to varying degrees, a Three Lines of Defence model. Therefore, based on which "Line" the Risk and Compliance professional will sit will have an impact on the type of desired attributes, for example:

- *Line 1* Risk and Compliance professionals are likely to need strong product knowledge and a detailed understanding of how fund managers or superannuation organisations operate. Also, these individuals need strong communication and influencing skills to ensure the business maintains their ownership of risk and compliance.
- *Line 2* Risk and Compliance professionals, on the other hand, generally require greater knowledge and experience in applying the principles of risk and compliance across different types of businesses. There should be an emphasis on understanding and applying best practice in relation to framework implementation, policy development, assurance, as well as reporting. Individuals within this Line also need to play a role in the strategic direction of the organisation by applying necessary scrutiny and challenge. This has been discussed further in Section 6 – Beyond our shores.

During the period, 41% of respondents suggested it took, on average, 3-6months to fill a Risk and Compliance role, which is comparable to the 4 months reported last year. In order to attract and retain the right Risk and Compliance professionals, organisations need to ensure they have a customised engagement model that focuses on the growth and development of Risk and Compliance employees both within the function and into the broader business.

97% of respondents suggested they operate, to varying degrees, a Line of Defence model.

4

Risk Culture

Similarly to other parts of the organisation, Risk and Compliance functions are being asked to do more with less. In response to this, organisations and regulatory bodies are turning their focus to Risk Culture as a way to re-set and place greater accountability and ownership for Risk and Compliance in all layers of the organisation. As a result, we are starting to see an increase to have Risk Culture specific reporting and discussions at a Board and Committee level. As the industry continues to mature the thinking in this space and APRA's 220 Prudential Standards come into play, we believe Boards and Committees will be turning to their Risk and Compliance functions to play a significant role in:

- Understanding and articulating the current state of Risk Culture
- Developing and implementing strategic initiatives to build and / or continually improve their target Risk Culture
- Monitor and maintain evidence to support the organisation's commitment to embed a positive Risk Culture
- Engaging and managing the Regulators' expectations.

These new responsibilities present significant opportunities for Risk and Compliance professionals to engage senior management and other change functions within the organisation. Whilst many organisations are starting with surveys to assess the 'as is' state, more advanced organisations are trying to use behavioural observations, data analytics and focus groups to truly understand the levers and changes that need to be made to build an environment where *the right people, do the right thing, at the right time.*

Compliance focused

Minimum done to meet regulatory requirements

Current culture focused

Detailed understanding of and insight into current state culture and drivers

Future focused

Insights to inform a robust plan to transition to a best practice future state

Regardless of the approach taken, in our experience there are a number of factors critical for success when embarking on a Risk Culture journey:

Aligned to the broader organisational agenda – Risk Culture will struggle to get 'air-time' and be perceived as valuable to the broader business if they cannot see how it links to organisational strategy. Actively demonstrating how risk can enable the delivery of strategy and weaving risk initiatives into other business initiatives will help accelerate Risk Culture maturity.

Alignment and coordination of risk initiatives – If there are multiple risk initiatives, then implementation needs to be coordinated to keep the business engaged and reduce the likelihood of duplication. The business needs to be clear how different building blocks fit together into the overall risk story.

Business and risk led – Risk and Compliance teams will not be effective in changing the Risk Culture if they tackle this on their own. To drive sustainable change it is important to have senior leaders within the business and key culture functions, such as HR, to partner with Risk and Compliance on the journey. This will drive greater engagement and ensure that solutions designed are fit-for-purpose.

Voice of the Risk and Compliance Officer

5

Extent of regulatory change, both domestic and offshore.

The main challenge is making sure the business understands our role.

Balancing and managing the natural tension between achieving compliant regulatory outcomes and commercial outcomes for the business.

Ensuring ongoing accountability for risk and compliance is embedded at the business unit level.

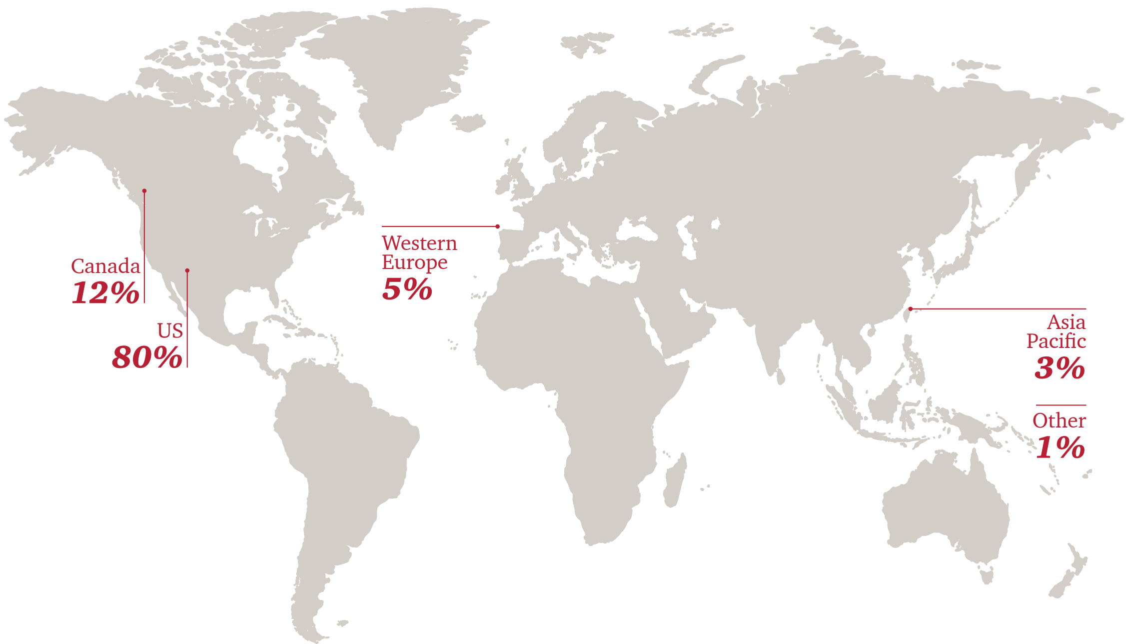
Risk and Compliance are continually seeking to enhance the monitoring and controls processes to ensure they align with good practice.

Finding the right people with both compliance and stakeholder management skills.

6

Beyond our shores

An insight from Murray's interim report suggests the biggest risks to our financial system are not local, but global. Given this statement, we have sought to provide insights from PwC's State of Compliance Survey conducted in the United States (US Survey) and compare this against Australian trends.



What it means to be a "Chief" Compliance Officer

The US Survey is completed on an annual basis and focuses on the role of the Chief Compliance Officer (CCO) in a variety of industries. It was found that the role of the CCO has gained more prominence over the last decade and is evolving rapidly. Today's CCOs are in a position similar to that of CFOs 15 years ago, and face a similar opportunity and challenge: how to become a more strategic partner in the organization, a vital member of the C-suite.

What was evident through the US Survey is that many CCOs are understandably challenged to meet the new demands placed on them while being able to elevate their position to the next level. It is suggested, to assume a more strategic role in their organisation, CCOs could:

- ***Engage with the business in more meaningful ways*** **–** Most businesses approach their activities through the lens of the customer. Understanding how compliance influences / impacts this view will help drive relevance for both sides.
- ***Strive to understand the needs of the business and the role of compliance in helping to address them*** **–** While it's important to ensure the business is appropriately managing its risks and compliance obligations of today. Understanding and speaking to the business on how it operates and strategic direction will provide inroads in demonstrating the value of compliance.

In addition to the strategic activities above, CCOs could look at other mechanisms to increase their relevance to the business. In particular, enhancing the current state of compliance reporting to demonstrate how the compliance function contributes to the successful execution of the corporate strategy.

6

The challenge of dual role

Taking a closer look at the role of the CCO, it was found that, in many companies, compliance is an add-on responsibility for another function. 27% of respondents said that the person most responsible for compliance wears multiple hats. A similar insight is present amongst our Australian respondents.

When compliance is an add-on responsibility, it may not receive the attention it requires. It can sometimes take a significant compliance failure – and a substantial fine – to drive home the wisdom of wearing just one hat.

Financial Service organisations*	AU Fund managers and super annuation funds
93% of organisations have a CCO/Head of Compliance.	**90%** of organisations have CCO/Head of Compliance.
27% of respondents said that the person most responsible for compliance wears multiple hats.	**45%** of respondents said that the person most responsible for compliance wears multiple hats.

*Source: US State of compliance survey. Comparisons against the Australian Risk and Compliance benchmarking survey should be undertaken with caution due the differing respondent types and response rates.

Measuring business impact is often more effective than measuring activity

More than eight in ten respondents (87%) from the US Survey said they assess the effectiveness of their compliance programs on a regular basis. However, evidence suggests that many organisations are measuring activity rather than the impact of their compliance programs on the business. The following table sets out the top 10 activity-based measures used by the US Survey respondents:

The top 10 indicators and metrics respondents use when evaluating the effectiveness of their compliance program	
Compliance audit results	86%
Results from a regulatory visit	79%
Risk assessment results	77%
Training completion rates	47%
Customer and other third-party feedback/ complaints (not reported through hotline/helpline)	45%
Employee disclosures (e.g. conflicts of interest and gift reporting)	37%
External benchmarking	36%
Cost of non-compliance (penalties, litigation, and other consequences of non-compliance incidents)	32%
Hotline/helpline metrics	32%
Internal benchmarking	29%

Whilst the current approach and above measures are useful, other measures may do a better job of helping management to understand whether the organisation is more or less exposed to risk.

6

Alternative measures can include:

- Formal benchmarking against peer organisations
- Outcomes of employee questionnaires and cultural surveys
- Analyses of customers', employees', investors' and other stakeholders' social web content
- Number of significant organisational projects where Risk and Compliance were engaged
- Risk and Compliance recognition programs
- Feedback from Boards and Committees regarding useability and friendliness of Risk and Compliance deliverables (e.g. communications, reports, insight papers, etc.)

We are also seeing organisations within Australia challenge the current methods for delivering and managing risk. This has including exploring outsourcing of risk and compliance, which is becoming more prevalent within the United States.

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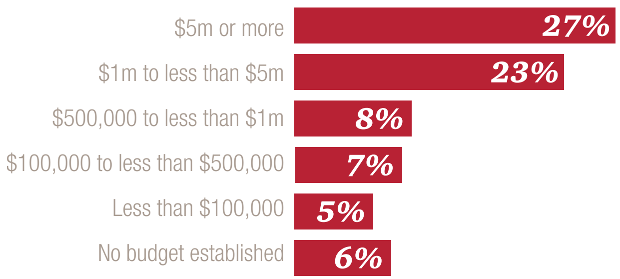
64%
of respondents state that compliance staffing levels have increased over the past 12 months.

60%
of respondents state that their compliance budget has increased this year.

Resources available to the CCO



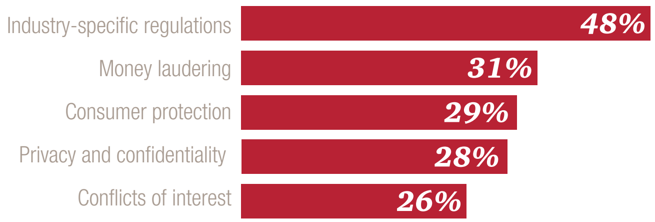
While these figures dwarf many of the budgets available to risk and compliance functions within the Australia, we are seeing greater scrutiny over risk and compliance budgets to extract greater value. This includes optimising Risk and Compliance processes to optimise and simplify, especially those that directly impact the client.

CCOs continue to focus on risks that they have traditionally "owned"

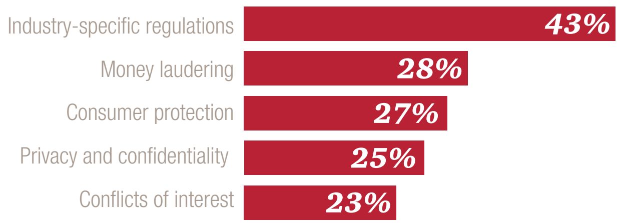
Industry-specific regulations such as money laundering and consumer protection remain the top-of-mind risks for respondents in the US. Interestingly, these same risks are also what respondents stated as future risks.

As mentioned within Section 4 – People and capability, respondents of the Australian survey have regulation risk top of mind, with 60% indicating 'regulatory change' a key risk and challenge in adding value to the business.

Top 5 areas in terms of current perceived level of risk



Top 5 areas in terms of future perceived level of risk



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Consider the future

In addition to the results of our survey, we have looked at some of the broader developments within the financial services industry that will likely impact Risk and Compliance professionals.

Global CEOs are saying that the key to survive and thrive in today's business world will be dealing with disruption.

This was the view of the more than 1300 CEOs from all over the world, including Australia, who responded to PwC's 16th Global Survey of CEOs.

The phenomenon of a 'Disruptor' (a term that has become widely used and often confused with innovation) was first used by Harvard Business professor Clayton Christensen who explained that a disruption *"displaces an existing market, industry, or technology and produces something new and more efficient and worthwhile. It is at once destructive and creative".*

Some top Disruptors impacting the financial services industry

Wealthfront	Giving mainstream investors access to wealth management services previously only available to high new worth investors
CoinBase	A "Central Bank" for Bitcoin
Lending Club	Borrowing without a Bank

What is common in all these Disruptors is that they have entered a traditional sector dominated by well-established incumbents and revolutionised them – in almost all cases taking the current way in doing things and looking at it through the eyes of the customer. This has often resulted in more simple and customer friendly products or service models. The desire to be customer centric is challenging long established business models, risk and compliance frameworks and client experience delivery at a much faster rate, requiring the risk and compliance function to keep pace.

Globally, the wealth management industry is showing signs of an industry on the verge of disruption. This presents significant opportunity for Risk and Compliance functions to change and elevate their importance and relevance by driving the discussion around how this risk is being managed at a strategic level.

Wealthfront – RoboAdviser

Wealthfront is an example of this phenomenon – its founders saw the potential to disrupt the traditional wealth management market by using big data, artificial intelligence and cloud technology. The founders had a mission to build a platform to solve an unmet need – giving mainstream investors access to wealth management services previously available only to wealthy individuals. After a year of operating, Wealthfront has become one of the world's most disruptive startups in the industry. In just one year, they have grown assets under management by 700% to $800 million.

BitCoin ATM – Revolutionising the client experience

This year saw the launch of the first Bitcoin ATM in Australia. Whilst this decentralised virtual currency is dividing opinions across the industry there is no denying the disruptive nature of this market entrant.

Aside from the currency itself, the ATM's have transformed the relationship and interaction between the consumer/client and institution. For the purpose of setting up a "Digital Wallet" (or account), the client stands in front of the ATM to have a photo taken (by the ATM's fitted camera), scans their handprint (on the ATM's touch pad) and swipes an official ID (such as a Driver's License). The machine processes the AML/KYC checks and in under 10 minutes the account is set up, or declined (if there are abnormalities). Compare this to the last experience you had in setting up an account or applying for a financial product.

These examples exemplify the benefits of taking a customer centric approach and reengineering the way in which risk and compliance controls are embedded in the customer experience. While these organisations have the luxury of starting afresh and learning from more established organisations, there is no denying their ability to influence and reshape the way in which we approach Risk and Compliance processes.

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