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Financial Services Forum

21-22 May 2018 • Hilton Sydney



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Risk Management Maturity in large Australian Superannuation Funds

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What is Risk Culture?

THE STORY SO FAR

'The shared perceptions among employees of the relative priority given to risk management, including perceptions of the risk-related practices and behaviours that are expected, valued and supported'

Why? Governance/policies/controls alone are not sufficient.

Espoused vs Enacted.

Not risk appetite, not risk structures, not behaviour per se.

Risks: Credit, Operational (includes cyber, AML), Liquidity, Misconduct, Reputational etc.

Risk culture

Safety culture

Service culture

Innovation culture

Ethical culture

Sales culture

**All facets of
organisational
culture!!**

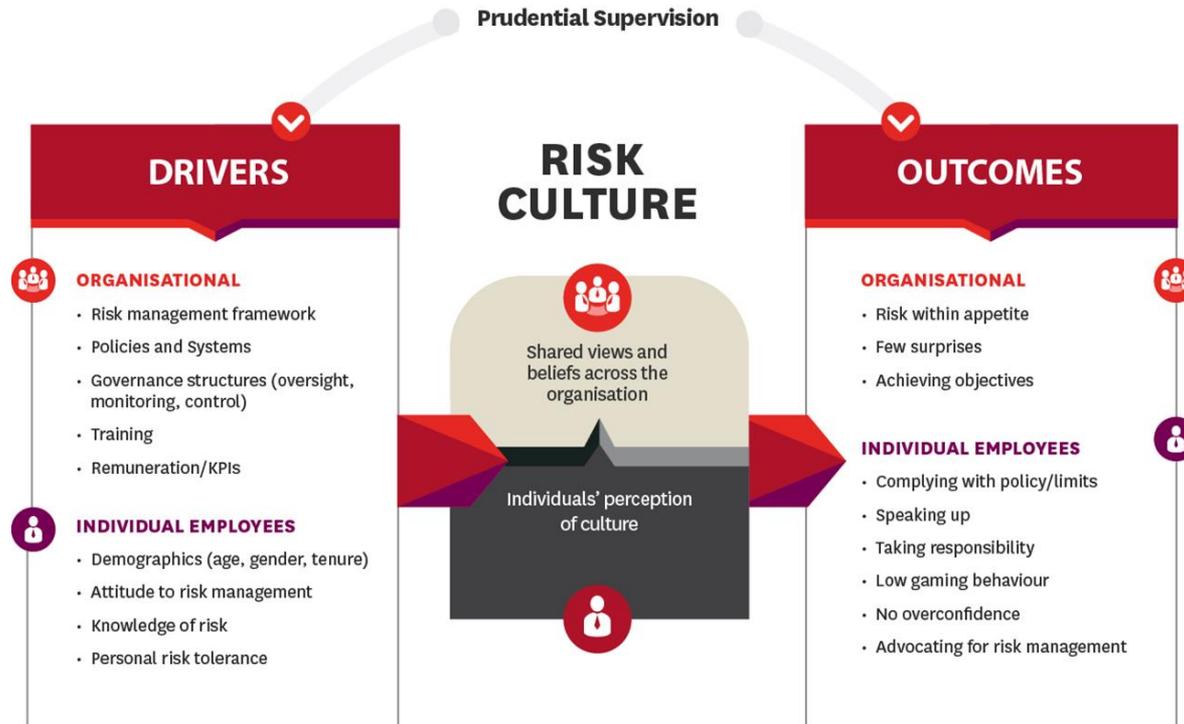
Components of Risk Culture

EACH 3-6 SURVEY ITEMS



Sheedy, Griffin, and Barbour. (2017) "A framework and measure for examining risk climate in financial institutions." *Journal of Business and Psychology* 32(1): 101-16.

Risk Structures, Culture and Behaviour



Sheedy, Elizabeth, and Barbara Griffin. "Risk governance, structures, culture, and behavior: A view from the inside." *Corporate Governance: An International Review* (2017).

Methodology



Document Analysis



24 Expert Interviews



Employee Surveys (in 5 large super funds)



Advisory Panel (ASIC, FSC, Mercer Australia and RSA Archer)

Risk in Superannuation

HIGH COSTS, LOWER RETURNS

- Strategic/tactical
- Governance
- Investment governance
- Liquidity
- Insurance
- Operational:
 - fraud,
 - employment practices and workplace safety,
 - clients, products and business practices,
 - damage to physical assets,
 - business disruption and systems failure,
 - execution, delivery and process management

Regulatory
Change!

Member disengagement

Aging
Population

Investment
Performance

Cyber
risk

CONFLICTS OF
INTEREST

*Outsourcing v.
Insourcing?*

Legacy systems

Consolidation
and efficiency
drive

Risk Management Maturity



Level 1 attributes (in addition to effective risk management systems):

- Commitment to continuous improvement
- Everyone has accountability for risk
- Risk management viewed as an enabler
- Risk communication is effective
- Right amount of the right risks

Effective Risk Management Systems

POLICIES, IT SYSTEMS, EXPERTISE, FRAMEWORKS

- *Large and very large funds are investing substantially in cutting-edge GRC systems. There have been a number of implementation issues as systems and new processes are bedded down and risk professionals get more familiar with how the GRC tools work in practice. (Consultant)*
- ***In my fund, risk frameworks and systems are still being established. We were using spreadsheets to run our risk and control assessments until recently. (RP)***

Capable risk teams are not as common as they should be. People have fallen into the profession rather than choosing it. Frameworks are a dime a dozen but a capable risk team is what makes the framework actually work. (TD)

Lots of risk people in super come from compliance background and struggle when issues require judgement. (RP)



Effective Risk Management Systems

POLICIES, IT SYSTEMS, EXPERTISE, FRAMEWORKS

On our board risk committee the member-nominated directors lack expertise and they are too passive. It's not that they block or oppose risk initiatives – their hearts are in the right place. It's more that they don't have much to contribute to the discussion or to solving problems. (RP)

Some of our directors still don't understand the three lines of defence or the difference between risk and compliance. It's easy to find directors with relevant expertise for audit/compliance but much harder for risk. We have to really push them to be forward looking and proactive. (RP)

If you report to the CFO it's very difficult to have those honest conversations – the risk function needs to be independent of the finance function. (RP)

In superannuation it's unusual for risk to have a seat at the Executive Committee. This limits the influence of risk. (RP)

Employee Perceptions of Structures

Four Dimensions	Proportion of Favourable* Factor Scores in Superannuation Funds			
	A	B	C	D
<i>Performance and Remuneration:</i> Perceptions that performance measurement and reward systems encourage a focus on risk management.	64%	46%	58%	52%
<i>Risk Managers:</i> Perceptions of the efficacy of those staff with additional risk responsibilities.	93%	76%	87%	88%
<i>Risk Knowledge:</i> Perceptions of the risk management knowledge and expertise within the organisation.	96%	96%	96%	95%
<i>Risk Training:</i> Perceptions of the quality and applicability of staff training relating to risk.	97%	88%	95%	96%



Commitment to Continuous Improvement

- *Many people in the industry tend to be driven by regulation rather than being intrinsically committed to risk management. (RP)*
- ***In my fund I'm delighted that new risk management initiatives generally get a very good hearing. I gather from my peers that this is not true in all funds. (RP)***
- *Many funds don't want to invest enough in risk management. They are averse to change and very cost-conscious. (Consultant)*
- ***Too often I see funds that do the bare minimum to comply with regulations. (Consultant)***

Everyone has accountability

FOR RISK MANAGEMENT

- *The biggest challenge we face is keeping risk at the front of peoples' minds when they have big busy jobs. (TD)*
- ***Improving front line accountability is a significant issue for the industry (RP)***
- *Around here people are focused on following existing rules rather than questioning whether they make sense. (RP)*
- ***There's a tendency in the industry to see risk and compliance as the same thing (RP).***

3 Lines of Defence

Line 1 = Business

Line 2 = Risk/Compliance

Line 3 = Internal Audit



Risk Management Viewed As Enabler

- *It's hard to overcome negative views of risk i.e. blocking the business v. enabling the business (RP)*
- ***It's difficult to get sufficient resourcing into risk. I think that's because risk is not seen as an enabler that can help the business. (RP)***
- *In my fund it's still a battle for risk to truly be an enabler. I aim to hire risk people who are approachable, collaborative, solutions focussed. Such people are hard to recruit from outside so we need to develop from within. (RP)*

New Survey Items

EMPLOYEE PERCEPTIONS

	Unfavourable response	Favourable response	Proportion of Staff Responding Favourably in the Organisation			
			A	B	C	D
1. Lines of accountability between the business and risk/compliance teams are:	Confusing...	...Very Clear	81%	62%	76%	83%
2. Risk management in this organisation is characterised by:	Mere compliance ...	...Thoughtful engagement	80%	61%	73%	76%
3. Risk management in this organisation is:	Ineffective ...	...Very effective	93%	79%	91%	93%
4. Risk management in this organisation:	Meets regulatory requirements and no more...	...Is embraced as the best way to do business	87%	68%	81%	87%

New Survey Items

EMPLOYEE PERCEPTIONS

	Unfavourable response	Favourable response	Proportion of Staff Responding Favourably in the Organisation			
			A	B	C	D
5. Except for risk specialists, staff tend to see risk management as:	A drag on performance...	...An enabler for success	80%	64%	63%	74%
6. Risk management in this organisation is seen as the primary responsibility of:	Risk/Compliance ...	...Business operations.	47%	51%	50%	63%
7. In the last year we have been surprised by significant unforeseen outcomes:	Regularly...	...Never	97%	70%	65%	74%

Right amount of the right risks

- *Boards are trying very hard at this – I rate our efforts at around 6 or 7 out of 10. To do risk appetite well you need to be very clear on your business strategy i.e. are you an innovator or more of a follower? (TD)*
- **Few funds are doing appetite/tolerance reporting well (Consultant).**
- *Proactive identification of emerging risks is challenging in many funds, and this is true in other industries as well (RP).*

Risk communication is effective

- *We see discussion and learning from risk events as crucial. (Consultant)*
- **Staff are less likely to raise issues if leaders appear not to be listening or fail to respond appropriately. (TD)**
- *Around here there is not enough questioning/challenge (RP)*
- **For risk maturity you need staff who are willing to push-back and challenge. (Consultant)**

Under-reporting Risk Events

Sometimes I skip reporting a risk event because:

(Tick any that apply)

- I don't want to go through the follow-up interviews and questions
- Risk managers lack the expertise to understand/address the issue
- I doubt that anything will be done to fix the problem
- Work pressure
- Our risk system is so cumbersome
- I assume somebody else will probably log it
- I prefer to focus on solving the issue itself
- It might reflect poorly on our business
- Reporting might hurt our chances of getting rewards or recognition
- The event is not material
- I don't know how to report a risk event
- I don't think it's part of my role
- Other (please explain)
- **None of the above, if I was aware of a risk event I would always ensure it had been reported.**

<p>How likely is it that the following would be captured in your risk reporting system? <i>Slider from Highly Unlikely to Highly Likely (6 point scale) 'Don't Know' option included</i></p>	<p>Proportion of Responses in the Organisation who think the event likely to be reported.</p>
A breakdown in a procedure impacting 30% of members.	80% - 95%
A breakdown in a procedure with no member impact.	56% - 85%
A delay in issuing mandatory member communications beyond legislative timeframes.	74% - 83%
Member complaint resulting in adverse media coverage.	80% - 88%
A delay in project implementation.	80% - 77%
A delay in project implementation caused by failure in the oversight of a third party.	75% - 79%
Miscalculation of a component of a unit price which was identified and rectified prior to any transactions being processed.	69% - 83%
Fraudulent transaction request declined as a result of final approval process.	80% - 91%
Fraudulent death certificate provided by customer as part of claim.	70% - 90%
Customer complaint on social media	70% - 71%
Wrong information sent to one member	69% - 85%
System outage affecting non-customer facing systems	66% - 81%
Staff member accessing member information with no obvious business reason	53% - 66%



Risk Culture

Four Components of Risk Culture	Proportion of Favourable [#] Factor Scores in Superannuation Funds			
	Fund A	Fund B	Fund C	Fund D
Avoidance: Risk issues and policy breaches are ignored, downplayed or excused.	83%**	67%*	78%**	79%**
Proactive: Risk issues and events are proactively identified and addressed	93%*	80%	91%*	91%**
Valued: Risk management is valued within the organisation	94%**	79%	91%**	92%**
Manager: immediate manager is an effective role model for desirable risk management behaviours.	97%*	90%	96%*	96%**



Questions?

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Download the paper at:

www.ssrn.com/abstract=3171833