



An evolving landscape

2019 KPMG Wealth and Funds Management Publication

October 2019

kpmg.com/nz/





Contents

4 Foreword

∞ Industry Snapshot

12 Articles

33 Contributors



Foreword

Beckie McClelland Head of Wealth Management, Director, Risk Consulting KPMG



Anyone working in financial services in New Zealand will tell you that the sector is experiencing an unprecedented level of regulatory change and scrutiny. This is also true for the wealth and funds management sector. From a rise in consumer expectations to increased regulator scrutiny, global trends influencing the local market, and domestic competitors launching new products and services, the velocity and variety of change is significant and is unlikely to slow down any time soon.

It is a fascinating time to be part of the wealth and funds management industries in New Zealand, but we also find ourselves in a sea of change. Change can mean uncertainty but it also presents great opportunities.

KPMG is excited to be engaging with the wealth and funds management sector and providing thought leadership that sparks conversations. With change afoot for our sector, it is timely to pause and reflect on what it means for firms and their clients.

On behalf of KPMG, we hope you enjoy the read. Please do not hesitate to contact one of the team (listed at the end of this publication) to assist your organisation in addressing any of the matters raised.

Conduct and culture

The fall out from the Australian Royal Commission has had noticeable impact here in New Zealand, with banks and life insurance companies undergoing review in the conduct space. We are fortunate to hear from Financial Markets Authority (FMA) CEO, Rob Everett, with his outlook on how those in the sector should look to apply the findings and themes from these reviews.

Digital transformation

KPMG Partner, Mike Clarke unpacks the reality behind 'digital transformation'.

Mike looks to answer: What does this mean in practice and how can those embarking on, or already implementing, a digital transformation journey, set themselves up for success?

Fintech

Often we can look overseas to anticipate the next trends to arrive in New Zealand, albeit with their own Kiwi twist. This publication includes commentary from our KPMG Global colleagues, looking at how fintech such as cryptoassets, AI and robo-advice might be regulated in future and the challenges that this presents.

Corporate governance and risk

Arguably, expectations on board directors are higher than they have ever been, with regulators setting the bar for boards of publically and privately held organisations against defined corporate governance principles. KPMG risk specialist Rachael Pettigrew looks at the growing responsibilities of boards, and how important the tone from the top is in establishing an appropriate risk culture.

Advice and trust

We are seeing significant regulatory change related to the new financial advice regime set for introduction next year. Our clients tell us that they are seizing this opportunity to take stock of how they deliver advice and are viewing the change as a chance to better serve their clients. KPMG Partner, Matt Prichard, takes a deeper look to ask whether advisers are truly delivering a great advice experience, that in turn fuels the prosperity of New Zealand.

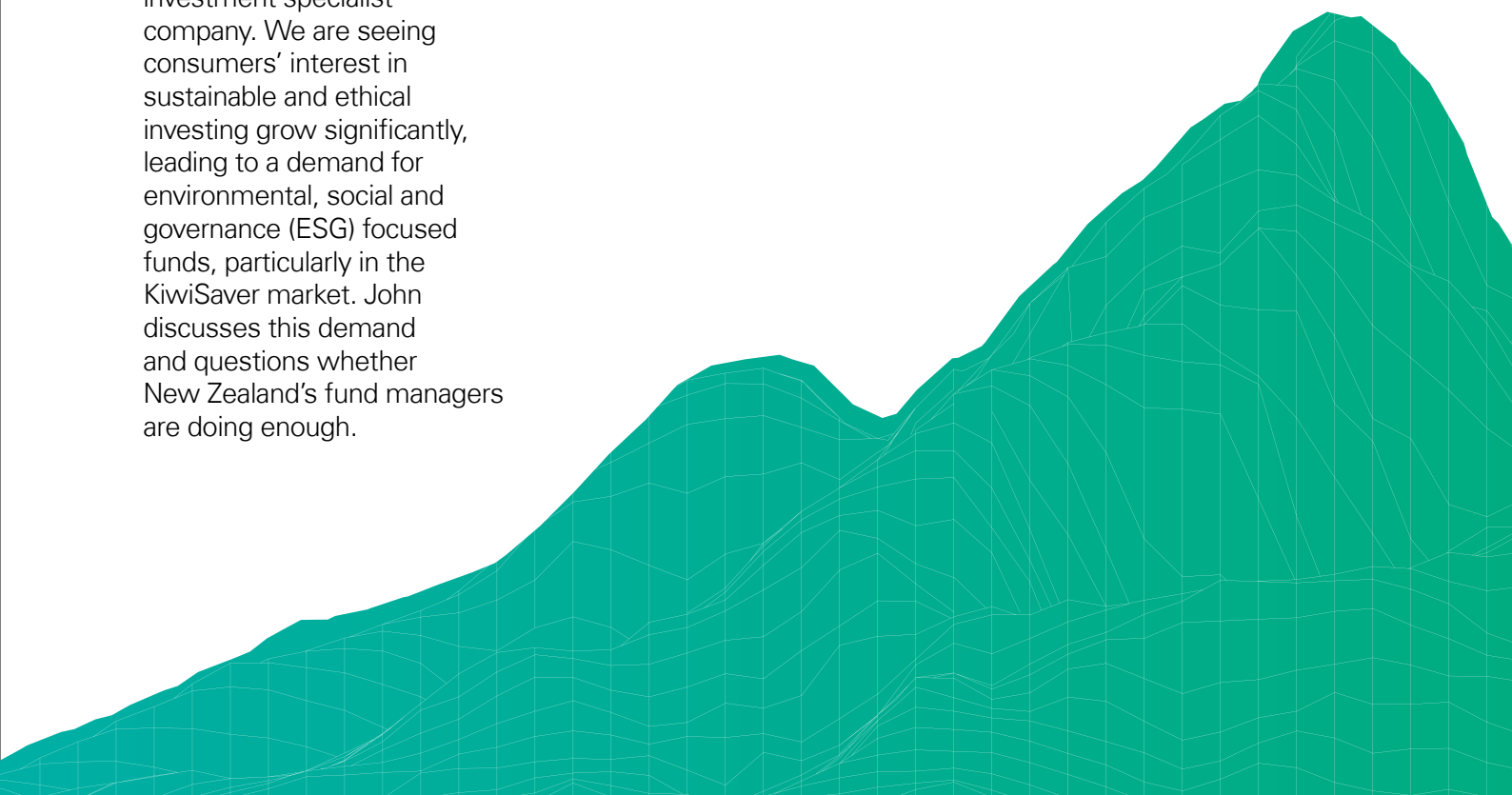
“

With change afoot for our sector, it is timely to pause and reflect on what it means for firms and their clients.

”

Responsible investment

We are also fortunate to include insights from John Berry, Co-founder and CEO of Pathfinder Asset Management, an ethical investment specialist company. We are seeing consumers' interest in sustainable and ethical investing grow significantly, leading to a demand for environmental, social and governance (ESG) focused funds, particularly in the KiwiSaver market. John discusses this demand and questions whether New Zealand's fund managers are doing enough.





A scenic landscape photograph of a fjord. In the foreground, a large, mossy rock sits in the water. The water is a deep blue, reflecting the sky. In the background, steep, forested mountains rise from the water's edge. A vertical teal bar is positioned on the right side of the image, containing the text "Industry Snapshot" in white, oriented vertically.

Industry Snapshot

Industry snapshot



133%

Sustainable investing assets in New Zealand grew by 133 percent from 2016 to 2018

39

In 2007, there were 39 founding signatories to the Principles of Responsible Investment (PRI), including the Guardians of the New Zealand Superannuation

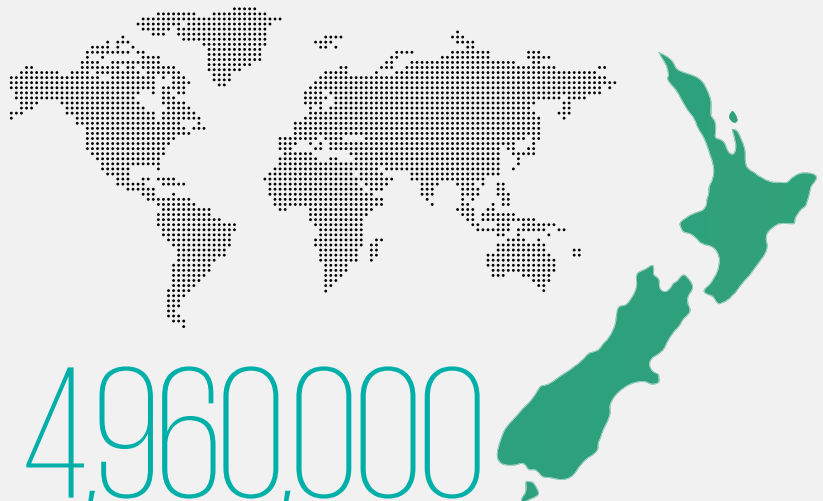
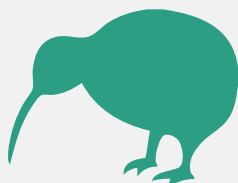


Of broad responsible investing approaches in 2018 were centred on ESG integration



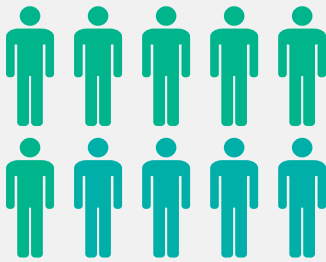
2,934,268

Number of New Zealanders invested in KiwiSaver*



4,960,000

Current population of New Zealand



57%

Percentage
of the total
population
invested in
KiwiSaver

\$57 Billion

Total amount invested
in KiwiSaver*



* FMA Annual KiwiSaver Report 2019



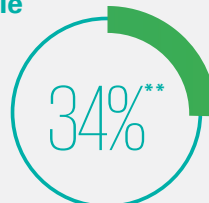
23

Number of ethical/
responsible investment
KiwiSaver schemes

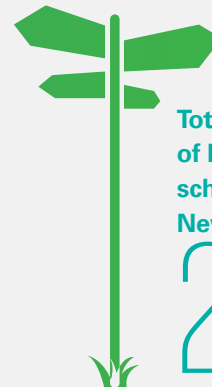
Globally, sustainable
investing assets
in the five major
markets stood at

\$30.7 trillion

at the start of 2018



**increase in 2 yrs

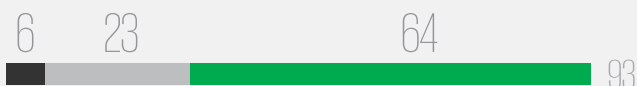


Total number
of KiwiSaver
schemes in
New Zealand

277

Industries that New Zealanders rate the most important to avoid in KiwiSaver funds or investment schemes

Animal cruelty



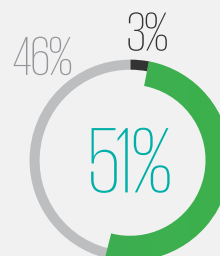
Human rights abuses



Labour rights abuses



■ very important
■ important
■ somewhat important



Of those surveyed,
51% are more likely to
invest in a Kiwisaver
scheme that takes
ESG factors into
account in addition
to financial returns





Articles

A wider view of conduct and culture

Rob Everett – Chief Executive, Financial Markets Authority



“... insurers have been “too complacent when it comes to considering conduct risk”, and “not focused enough on developing a culture that balances the interests of shareholders with those of customers”.

Conduct and Culture – what were we looking for?

As the FMA and the RBNZ delved into the conduct and culture of banks and life insurers last year, there was an air of anticipation as people asked: “Will they find misconduct as bad as that in Australia?”

We went into the reviews with a much more mundane, but no less important, question: “How well are these firms managing conduct risk?” We were not just looking for signs that the law had been breached. We wanted to see how firms had designed and implemented risk identification and risk management processes related to customer treatment and care.

After all, every issue identified in Australia was the result of poorly-managed conduct risk, where actions taken by providers, their staff, or their advisers and intermediaries caused customers harm or left them with products they didn’t need or benefit from.

Conduct risk is a feature of all aspects of financial services. It is the danger that the way staff, managers and boards act will have an adverse effect on the outcomes experienced

by customers. It can be managed in part by having solid processes, systems and controls. However, effective management of conduct risk ultimately depends on the firm’s culture – what it values, what behaviour it models and what outcomes it rewards.

How is conduct regulated in New Zealand financial services?

Regulation and oversight of advisers is inconsistent. Authorised Financial Advisers have conduct obligations under their Code of Conduct and the Financial Advisers Act. Registered Financial Advisers have fewer conduct obligations and are not subject to a Code of Conduct. Qualifying Financial Entity advisers are generally not registered or authorised, but the entity itself must demonstrate that it maintains procedures to ensure retail clients receive adequate protection.

Fund managers investing on behalf of retail customers are licensed under the FMC Act, and we have imposed conduct-focused requirements on these licences. The FMC Act also sets out minimum compliance standards of behaviour related to fair dealing for specified products and services.

Limited by this relatively narrow coverage of ‘enforceable’ conduct obligations, in early 2017 we published our Conduct Guide, which reiterated the position we’ve held since the FMC Act was passed in 2013. It sets out our expectations for conduct across financial services – all sizes and types, licensed or not – to encourage anyone selling or advising on financial products to consider the issues and challenges of how to treat customers well.

Conduct and Culture findings

While we were encouraged that our review provided little evidence of any widespread breach of the law or misconduct, we were not impressed with the lack of rigour and resource applied to conduct risk.

In the life insurer report, we said insurers have been “too complacent when it comes to considering conduct risk”, and “not focused enough on developing a culture that balances the interests of shareholders with those of customers”. These themes are equally applicable to all financial service providers, including the rest of the wealth sector.

Given our consistent messaging that all financial

service providers should actively manage conduct risk, we have taken the opportunity provided by the Conduct and Culture reviews to push hard at the entire industry and publicly challenge them to up their game. This challenge applies to the regulators too. We cannot let what happened in Australia happen here.

What should the rest of the industry be doing?

As we know that good conduct and culture is set at the top, we are looking for boards and management teams to provide leadership and assurances about how conduct risk is managed.

With this in mind, I encourage all wealth management firms to closely review the findings in Commissioner Hayne’s report on the Australian Royal Commission, where he set out six principles for good conduct:

1. Obey the law
2. Do not mislead
3. Act fairly
4. Provide services that are fit for purpose
5. Deliver services with reasonable care and skill
6. When acting for another, act in the best interests of that other

The high-level recommendations from our Conduct and Culture reports can help firms put Hayne’s principles into practice:

- Greater board and senior management ownership and accountability
- Prioritise issue identification and remediation
- Prioritise investment in systems and frameworks
- Focus on longer-term customer outcomes
- Strengthen staff reporting channels
- Remove all incentives linked to sales measures, or take steps to manage the risks associated with incentives.

Some areas of wealth management, particularly those that service sophisticated or high-net-worth investors, or do not deal with customers face-to-face, may be inclined to take a more relaxed approach to managing conduct risk. This is short-sighted and risky, and may ultimately indicate deeper issues with the business. For a well-managed firm, managing conduct risk should come as naturally as seeking a profit.

Good conduct makes good business sense. It focuses on meeting the needs of

customers, and aims to ensure they are treated fairly and with integrity. It also assures shareholders that the firm's vision and priorities are sound, that there is an embedded and long-term commitment to doing the right thing, and that they will ultimately benefit from the sustainable value of customer loyalty and a good reputation.

I often get asked how to instil greater confidence in financial advice and wealth management. Research shows that many potential clients just don't trust the industry. They want to know who is paying who and for what, and what practices or behaviours the often-complex fee structures are potentially driving. So, in the same way that we have aggressively attacked banks' sales incentive structures where they create a risk of poor sales practices, I would challenge all firms to look at incentives for those dealing with customers.

There's little point blaming regulators, politicians or the media for the low level of use of financial advice in New Zealand. Building a relationship of trust with consumers needs to come first. Banks, insurers and all other parts of the industry must make changes based on the lessons from the Conduct and Culture work. The Financial Services Legislation Amendment Act and the new Code of Conduct will be a big shift for advisers, but will create an environment where all those giving financial advice are subject to the same regulatory requirements and obligations. We at the FMA also have a ton of work to do.

But it will be worth it. Raising standards and ensuring transparency for customers will encourage those who ought to be insured, advised or invested to do so with confidence.

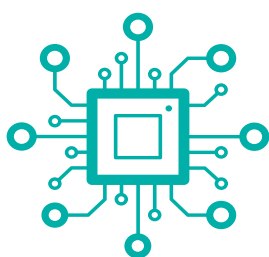
“

Good conduct makes good business sense. It focuses on meeting the needs of customers, and aims to ensure they are treated fairly and with integrity.

”

Leading digital transformation

Mike Clarke – Partner, IT Advisory, KPMG



Digital transformation is not 'one size fits all', so let's start and end with questions.

How do you perceive 'digital transformation'? Is your organisation doing it well? Who is doing it well in your industry?

In the wealth management sector there are a number of drivers behind digital transformation.

These may include:

- response to regulatory change and pressure on fees
- opportunity to differentiate through customer experience, robo-advice or AI capabilities
- addressing a demographic change as we see five generations in the workforce for the first time.

Whatever the driver, transformation isn't easy. By its very nature it means doing things differently, which as we all know, is easier said than done. Successful transformation requires significant leadership and change management.

KPMG New Zealand's latest CEO Outlook Report shows that New Zealand CEOs are becoming less optimistic about the impact of transformation programmes. A year ago, 46% of New Zealand CEOs disagreed there were long lead times for achieving significant progress from the disruption that transformation inevitably brings, and in 2019 that has decreased to only 4%. Another significant data point is the expected return on investment (ROI) from digital transformation programmes. Our global counterparts have much higher expectations, with an average of 84% expecting a return within three years compared to 60% of New Zealand CEOs.

So why is this? From the survey responses, there are four areas to examine; innovation culture, leadership, scope and solution design. These areas are inter-connected and their impacts are cumulative.

An innovation culture includes trust, accountability and agility, which embraces a 'fail fast' mind-set. This is a significant change from traditional business models.

The positive news is that 58% of New Zealand CEOs agree that they want their employees to feel empowered to innovate without worrying about negative consequences if the initiative fails, which compares favourably to

Australia at 40% and is similar to UK CEOs at 57%.

However, only 4% of New Zealand CEOs agree that their organisation has a culture in which 'fast failing', unsuccessful innovation initiatives are celebrated. This compares to Australia at 40% and UK CEOs at 19%. How are you addressing this in your organisation?

A second area for consideration is leadership. The data shows that 70% of New Zealand CEOs say they are personally leading the technology strategy for their organisation compared to 89% in the United States, 81% in the UK, and a similar 74% in Australia. So, are our C-suite executives sufficiently engaged in the leadership of transformation programmes? Does too much responsibility sit with the digital or technology leadership? Would more active participation and leadership lead to better or quicker results?

While the survey reflects New Zealand CEOs' concern around the pace and effectiveness of digital transformation, are the programmes scoped and resourced for success?

The first question is whether the transformation is focused on a single function or the enterprise? Many organisations have started their digital journey with single functions – often customer service (self-service),

leading to other aspects of the customer journey such as acquisition. If executed well, this will be effective, but may not deliver the full expected value because the digital processes will connect with traditional, analogue processes.

There will be value generated by digitally transforming functional areas such as operations, HR, procurement or finance and if they represent a significant part of the value chain, this may be the correct focus. However, this is not enterprise transformation and should not be measured as such.

For enterprise transformation, research conducted by KPMG and Forrester Research shows that organisations investing in and connecting eight capabilities are about twice as likely to see overall success. This may sound daunting but it reflects the 'and' nature of business – success is about being good at capability one, and two and three. For example, the positive impact of superb online channels is reduced if the customer's experience with the call centre channel is a poor one. Or, a strong digital ordering approach can be diminished by poor delivery experience.

So, the eight capabilities are;

1. advanced data and analytics to be insight led
2. to innovate through product, pricing and customer strategy

3. experience centricity
4. seamless commerce and channels
5. responsive supply chain and operations (supply chain includes product providers)
6. organisation alignment and people capability to be agile and empowered (innovation culture)
7. technology architecture and enablement to be digitally enabled
8. partnerships, alliances and vendor management.

To achieve this amount of change requires a digital transformation journey, which requires careful and deliberate planning. A digital transformation blueprint should adapt to the customer, business and market needs.

As part of becoming a more digital organisation, many are moving to agile ways of working. Not limited to agile project delivery, but a broader organisational shift to a different way of working. At some level, it is highly likely that agile methods and approaches will become part of your business if you are making digital transformations. Agile models, of which there are several, need to be tailored to your business.

Our experience tells us that for programmes that under-deliver, the scope is often ambiguous and the benefits, while well-defined at the outset, are not carefully tracked through the life of the

programme. So, irrespective of which agile methods are adopted, the governance layers are vitally important to address CEOs concern about return on investment.

Do the eight capabilities resonate with you and the future of your business? How will you use these to reflect on, continue or start your own digital transformation journey?

“

The data shows that 70% of New Zealand CEOs say they are personally leading the technology strategy for their organisation compared to 89% in the United States, 81% in the UK, and a similar 74% in Australia.

”

A word on fintech:

The regulators' dilemma

KPMG International – A sea of voices – Evolving Asset Management Regulation report 2019



Fintech

“Technologically enabled financial innovation that could result in new business models, applications, processes or products with an associated material effect on financial markets and institutions and the provision of financial services.”

Financial Stability Board

Fintech developments are coming thick and fast. They have already become a powerful external driver of regulation.

The regulators have a dilemma: they are called on to support and help nurture nascent industries that increase efficiency and help consumers to access financial services, but they are concerned about new and heightened risks.

Regulators are rethinking how they regulate the industry – both new fintech entrants and existing businesses that are encompassing fintech developments. Existing conduct rules were largely written in a paper and face-to-face world. Are the rules fit-for-purpose in a digital age?

KPMG’s report on the regulation of supervision of fintech¹⁶⁵ describes the regulatory responses to the ever-expanding expectations of external voices – society, consumers and counterparties.

The impact on asset managers and investment funds

Asset managers and investment funds are caught up in the general wave of fintech-related market and regulatory developments impacting the financial services industry. These include: regulatory concerns around cyber security, data protection and cloud outsourcing; the increasing use of distributed ledger technology (DLT) in payment, clearing and settlement systems; and developments in AI and robo-advice.

On cyber security in particular, regulators are increasingly turning their attention from banks and market infrastructure to asset managers. As well as expecting firms to have appropriately qualified staff, some are requiring the use of an independent expert. Industry bodies are responding to this increased regulatory focus by setting up new working groups and offering bespoke seminars and training sessions.

For example, the French Asset Management Association (AFG), released its annual survey of 70 asset managers in October 2018. Half of respondents said cybersecurity was among their top three risks and 35% had a dedicated insurance

¹⁶⁵ assets.kpmg/content/dam/kpmg/xx/pdf/2019/03/regulation-and-supervision-of-fintech.pdf

policy (up from 15% a year earlier). However, 70% still did not have a security operations centre and only half declared that they have a named person responsible for information systems security.

The key findings in December 2018 of a cybersecurity review by the UK's Financial Conduct Authority (FCA) of 20 UK asset management firms and wholesale banks included:

- Despite growing focus on cybersecurity across financial services, boards and management committees are not familiar with the specific cyber risks their organisations face
- Some risk and compliance functions have limited technical cyber expertise, which results in over-reliance on third-party advisers
- Many firms did not consider actively how they could incorporate cybersecurity risks into their broader risk approaches

Harnessing market developments

Three fintech developments, and the regulatory responses to them, are of particular note for fund managers: the use of DLT in processing transactions in fund units or shares; whether cryptoassets

are eligible investments and whether 'tokens' might replace fund units; and robo-advice.

Governments and regulators worldwide are being urged to help the development of DLT. OECD Secretary General Angel Gurría said in January 2019, at the opening of the OECD's Blockchain Policy Forum, that governments have a role to play in keeping markets fair and helping new innovations.¹⁶⁶

A number of national, regional and global fund transaction platforms are being launched, based on DLT. They cover a range of services, including order routing, maintenance of shareholder registers, settlement and payment, real-time transfers of fund shares and reconciliation.

Cryptoassets: a mixed approach

Amid volatile prices for cryptocurrencies, there is a degree of regulatory skepticism over cryptoassets and their underlying technology, DLT. Responses vary from jurisdiction to jurisdiction, as evidenced by a recent report by Cambridge University's Centre for Alternative Finance.¹⁶⁷ Some are moving to treat cryptoassets as financial instruments, others are opposed. This picture was confirmed by

the Financial Stability Board (FSB) at end-May 2019 and the International Organisation of Securities Commissions (IOSCO) is consulting on the regulation of crypto-asset trading platforms.¹⁶⁸

UAE investment funds investing in cryptoassets are regulated as financial instruments by the Abu Dhabi Global Market (ADGM) regulator, and Kuwait has introduced rules on who can deal as primary or secondary. In Hong Kong, a Securities and Futures Commission (SFC) statement¹⁶⁹ on the regulatory framework for virtual asset managers, fund distributors and trading platform operators says that only professional investors should be allowed to invest in

“

... there is a degree of regulatory skepticism over cryptoassets and their underlying technology, DLT.

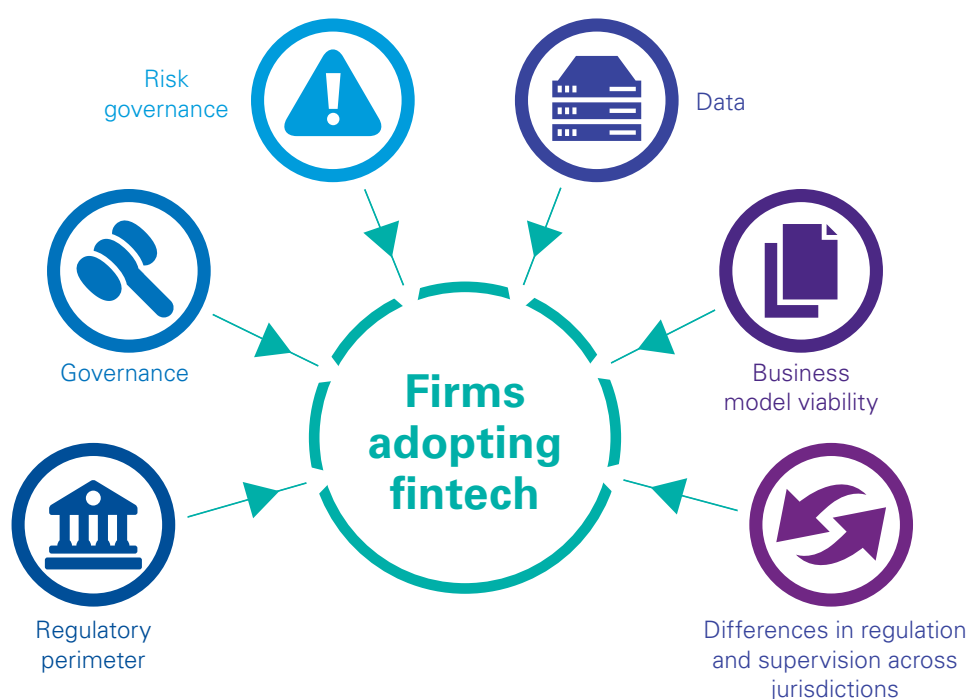
”

¹⁶⁶ www.oecd.org/about/secretary-general/high-level-panel-blockchain-for-better-policies-paris-september-2018.htm

¹⁶⁷ www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2019-04-ccaf-global-cryptoasset-regulatory-landscape-study.pdf

¹⁶⁸ www.iosco.org/news/pdf/IOSCONEWS530.pdf

Regulatory and supervisory pressures on firms adopting fintech



cryptoassets. And in Malta, the Virtual Financial Assets Act requires cryptoassets and cryptoexchanges to be licensed.

The Jersey regulator regards cryptoassets as security tokens and the Guernsey regulator, while cautious of the risks in crypto funds, has said it is open to approaches and willing to engage with firms on the necessary controls to safeguard investors. Similarly, the Cypriot regulator does not preclude applications for Accredited Investment Fiduciaries (AIFs)

investing in cryptoassets but says they would be assessed on a case-by-case basis.

An ESMA paper¹⁷⁰ in January 2019 found that cryptoassets do not give rise to financial stability issues, but it is concerned that they may pose risks to investor protection and market integrity, and it called for cryptoassets to be classed as financial instruments. It believes that the cross-border nature of cryptoassets calls for an EU approach and not differing national rules.

The European Commission is therefore considering legislation to address the need for legal certainty for this emerging asset class in order to ensure investor protection, market integrity and a level regulatory playing field within in the EU. The cryptocurrency exchanges and custodian wallet providers are already "obliged entities" under the 4th EU Anti-money Laundering Directive, but the 5th Directive expressly brings these into scope of the financial crime legislation from January 2020.

¹⁶⁹ www.opengovasia.com/hong-kong-sfc-sets-new-regulatory-approach-for-virtual-assets/

¹⁷⁰ www.esma.europa.eu/sites/default/files/library/esma50-157-1391_crypto_advice.pdf

¹⁷¹ www.loc.gov/law/help/cryptocurrency/france.php

¹⁷² assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752070/cryptoassets_taskforce_final_report_final_web.pdf

Cryptocurrencies should not be directly regulated, but should be ring-fenced from traditional assets, a French government report advised.¹⁷¹ The report said that cryptocurrencies should be allowed to develop, but there should be regulation of trading platforms and investments by asset managers should be restricted. An amendment to the Action Plan for Business Growth and Transformation (PACTE) Bill has made DLT an acceptable means of proving asset ownership, for traditional asset classes and cryptoassets alike. Also, professional investment funds will now be able to invest in cryptoassets registered into a DLT platform.

The UK Cryptoassets Taskforce's assessment¹⁷² of risks and potential benefits concluded that strong action should be taken to address the risks associated with cryptoassets that fall within existing regulatory frameworks, and that further consultation and international coordination are required for cryptoassets that fall outside the existing regulatory framework and pose new challenges to traditional financial regulation. The FCA subsequently issued in January 2019 draft guidance on the classification and treatment of cryptoassets, and how they align to the existing regulatory framework and perimeter.

AI and robo-advice

Robo-advice is being examined by regulators worldwide as the number of platforms and users increases. The key regulatory concern is that consumers must receive sound advice. Some regulators acknowledge that their supervisory techniques must evolve.

In Europe, the key findings of a report by the European Supervisory Authorities (ESAs)¹⁷³ included:

- Automation in financial advice has been growing slowly, with limited firms and customers involved
- The ESAs' original analysis of the risks and advantages of such automation remains unchanged
- Automated financial advice is being offered by established financial intermediaries rather than pure fintech firms
- Given that there has been limited growth and risks have not materialised, no immediate action is necessary, but there will be further work if market size, or the risks it poses, increase

The Luxembourg Commission de Surveillance du Secteur Financier (CSSF) published in December 2018 a white paper on AI, including robo-advice. The regulator is concerned that the fundamentals of AI

and its underlying risks need to be well-understood and an adequate control framework put in place. It cautions against robo-advice algorithms that favor investment funds with higher commissions and advises that firms "regularly monitor the effectiveness and appropriateness of the advice provided to avoid mis-selling".

Digital advisers in Singapore are expected to disclose certain information on algorithms, conflicts of interest and a written risk warning statement to clients. The Monetary Authority of Singapore (MAS) has also provided guidance on suitability of advice, asset management and execution of investment transactions.

At a distance

In recognition that the retail financial sector is increasingly digital, the European Commission is consulting until July 2019 on whether the EU Distance Marketing of Financial Services Directive 2002 remains relevant, effective and efficient, and is in line with other EU legislation.¹⁷⁴ The directive aims to protect retail consumers when they sign a contract with a financial services provider in another member state by imposing harmonised rules.

¹⁷³ esas-joint-committee.europa.eu/Publications/Reports/JC%202018%2029%20-%20JC%20Report%20on%20automation%20in%20financial%20advice.pdf

¹⁷⁴ ec.europa.eu/info/law/better-regulation/initiatives/ares-2018-6079786_en

The buck stops here:

Governance, accountability and risk culture

Rachael Pettigrew – Associate Director, Internal Audit and Risk Consulting, KPMG



U.S. President Harry S. Truman kept a wooden sign on his desk saying “The buck stops here”.

The sign stood as a reminder that whoever sat behind that desk needed to make decisions and accept responsibility for the outcome. However, statements that remind us of who is accountable, are often buried deep in governance documents.

Where does the accountability sit?

Roles and responsibilities of those who sit at a board or committee table can become warped over time. A post-mortem of the Global Financial Crisis clearly pointed the finger at those sitting around such tables. Board members who bathed in the glory of privilege prior to the collapse of the financial markets may have benefited from the “The buck stops here” mentality, sitting boldly on a block of wood, watching over their decisions. It could have been one of the cheapest, yet most effective hard controls ever implemented.

This ethos is applicable across the wealth management sector. While privately owned firms are not obliged to apply the NZX Corporate Governance Code requirements that their public counterparts are expected to comply with, the influence of good governance, and proactive accountability should not be discounted. Arguably, both public and private entities, especially those involved with offering products into which their customers invest for their futures, should aspire to not only comply with those higher expectations, but to view the rules applied to the publically listed companies as a benchmark to build upon.

History has shown that good risk governance is the difference between prosperity and failure. However, those in risk governance positions only have the sum of their personal experience, knowledge and capability to guide them - particularly when decision making lies outside their area of expertise. This raises the question – are those in risk governance positions knowingly accepting of this level of personal accountability? Or are they looking at their fellow members to be accountable on their behalf? After all, isn’t that why others have also been elected to the table?

What motivates the ‘tone from the top’?

We know that risk culture drives the performance of an organisation. By influencing and encouraging desired behaviours, we trust our people to make the ‘right’ decisions for the organisation. The synergy of these decisions, whether micro or macro, frontline or board level - is shared with everyone as performance indicators.

The key to unlocking performance is understanding the desired behaviours you want to focus on. One of the most influential behaviours that connects the board to their leaders is role modelling;

the values of an organisation require constant reinforcing if they are to live beyond a few placards on the wall. While governance meetings may happen under a veil of secrecy, members should not discount the many eyes analysing them. These governance meetings either support the notion that organisational values are being genuinely lived and breathed, or not.

Within our organisations, we look to those around us for indications of norming; 'the way we do things around here'. If we can't directly see our formal role model or leader, we will seek out people in our closer vicinity and adopt them as our role models. It is essential that an organisation's leadership are visible, and demonstrating the right values. The same applies to those who are ultimately accountable, and this begs the question - how can those with governance roles influence desired behaviours from behind closed doors?

All good news - nothing to see here

Good governance relies on groups of people making decisions. While we provide diverse minds to enable the best environment for decision making, the outputs will be heavily influenced by the inputs. A trend is emerging with the rise in the quantity, accuracy and manipulability of data. Where governance groups used to rely on insight and 'gut feel' from the report authors, this has given way to metrics, graphs and technical data. Not only is the content more complex - but the sheer volume of content seems to be expanding. This provides a real human challenge as Board members need to be able to absorb the content to

“

By influencing and encouraging desired behaviours, we trust our people to make the 'right' decisions for the organisation.

”

inform their decision making. Unless this upload can be achieved (and sometimes only on a small screen at 35,000 feet) it may be difficult for the audience to critically interrogate and challenge the reports.

Further to this is the over-refining of information. As more focus is being placed on delivery objectives such as 'on time' and 'on budget', the sacrifices made to provide this green light reporting can be overlooked. Reports can be over-edited, but is this for the benefit of the author or the audience? Or worse still, key risk indicators are buried under swathes of technical information and jargon in a bid to offload someone's responsibility.

Often within risk governance documents, responsibilities assigned to members may include such phrases as 'determine if effective' or 'responsible for the effectiveness'. These indicate a level of assessment is required. For example, if a responsibility indicates a member must 'determine the effectiveness of the risk management

framework' - this goes much further than seeing evidence that such document exists. It goes further than discussing the quarterly heat-map or re-litigating the assessment of a 'very high' risk so it becomes a more palatable 'medium' risk.

To determine the effectiveness, it would be necessary to conduct a post-mortem analysis on a risk that was realised and became an 'issue'. Was the risk identified and on the right register? Were the controls effective as reported? Were there controls in place to limit the impact? How did we respond? What are the new risks? Have we refined our process?

Where to from here?

People with governance roles will continue to be held accountable for their decisions - individually and as a collective. In order to fully discharge this responsibility, they need to look to the suite of governance documents for guidance. These instruments should clearly outline where the accountability starts, and stops. How those with governance roles go about fulfilling this duty will always be under scrutiny. Shaping the board reporting so content is directly aligned to governance responsibilities will go a long way towards optimal decision making.

By being more deliberate and visible in their actions, governance members can be accountable by positively influencing the behaviours of their organisation. And ultimately, play a part in the many decisions made every day that contribute to performance.

The buck stops here.
Nowhere else.

Advice is the heart and soul

Matt Prichard – Partner, Audit, KPMG



I can't help but open with a couple of Rob Everett's closing sentences from his article earlier in this publication:

"There's little point blaming regulators, politicians or the media for the low level of use of financial advice in New Zealand. Building a relationship of trust with consumers needs to come first."

As a regulator, Everett's driver is to increase trust and confidence in financial advice and wealth management. I'd make that the first of three reasons that New Zealand's wealth management sector must make advice the heart and soul of organisations.

“

For the sustainability of our local wealth management industry, we need to run organisations with substance, who have something at their heart that cannot be commoditised.

”

Advice builds trust



Everything else is worth nothing



Trusted advice will grow New Zealand's prosperity

Advice builds trust

We all know this implicitly. When someone really understands your circumstances, plans, worries, and dreams, and uses real expertise to produce a plan to balance them, giving you confidence in the complex world of investment – that is a marvellous feeling.

Advice is an intimate experience. We are vulnerable when we disclose to an adviser. We're sharing information about our families, our ambitions and maybe our health.

Unfortunately, too often in this country (and others) the experience is, in fact, quite poor.

Why might this be?

1. Hesitancy to provide advice

Although necessary, one risk of regulating advice and creating consequences for giving bad advice, is that nobody will want to take the risk of giving it.

Financial institutions are increasingly ensuring that where possible, risk is mitigated by refraining from giving explicit advice and when necessary, ensuring it is given within tight guidelines.

2. Perception of value

One of the fallouts of the spotlight on conduct and culture is the perception that it may result in less money paid to those who give great advice.

Of course, we need to look at the mechanisms for rewarding advisers. However, we must be mindful that every other sector is desperately trying to own the relationship with the customer, because they realise that the relationship with the customer is where the margin and value is.

Everything else is worth nothing

Our wealth sector, more than any other, has perfected the art of outsourcing, including:

- registry (tracking individuals and personal data)
- custodianship (safeguarding ownership of investments)
- governance (trustee oversight)
- administration (running the place, and accounting for updates on investments)
- Distribution (with or without advice)
- Investment management (acting on the risk/return appetite that has been agreed).

All of these are often carried out by other entities, at arm's length, for a fee.

So, what is left?

For the sustainability of our local wealth management industry, we need to run organisations with substance, that have something at their heart that cannot be commoditised - trusted advice stemming from meaningful relationships.

Otherwise, how can a local industry survive amongst the current generation of technology changes, that already mean most of these disaggregated roles could be done efficiently from anywhere in the world?

Trusted advice will grow New Zealand's prosperity

A trusted, domestic wealth management sector is essential to growing New Zealand's prosperity, and advice is at its heart and soul.

Hollowed out networks of dispassionate service providers can never deliver the outcomes we need as a country from our wealth management.

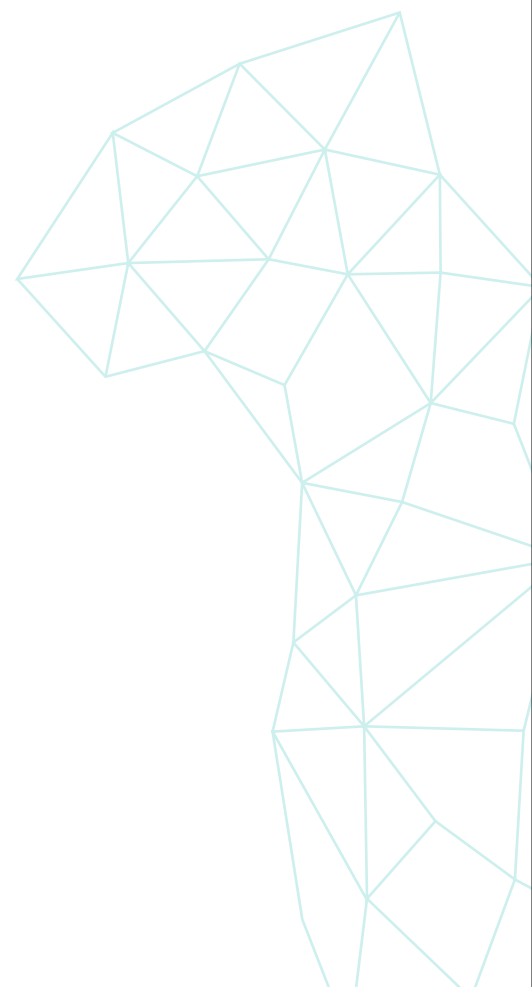
Being trusted, and having a meaningful domestic presence means;

- a higher chance that more New Zealanders will engage with capital markets, and invest more
- a higher chance that the advice they get will be

good advice, the product will be suitable for their circumstances, and their investment outcomes will be better

- a less fragmented, more resilient and more profitable wealth management sector, with a clear purpose, and great advice as its heart and soul.

Over the long term, I believe these things are key to New Zealand's and New Zealanders' wealth, health and wellbeing.



Nowhere near there, yet:

Responsible investing

John Berry – Co-founder and Chief Executive, Pathfinder Asset Management



In its early days, Google tapped into the groundswell of discontent with global corporates by adopting the 'Don't Be Evil' code of conduct. That very low bar was recently replaced with its 'Do the Right Thing' approach - encouraging positive action.

Wealth managers have also caught on. Investor desire to align how their capital is invested with their personal values have turned Responsible Investing (RI) into a very big business. According to the Global Sustainable Investment Alliance, more than US\$30.7 trillion in assets are now managed under responsible investing strategies. ⁽¹⁾

This means business leaders can no longer ignore public perceptions of their corporate ethics. Public perception is a powerful force affecting every company's brand and touching deeper into its social licence to operate. As Financial Markets Authority (FMA) CEO Rob Everett recently put it, the tide has turned in terms of what the public and the community at large expects from corporate leaders. "Regulators and the law should reflect the expectations and needs of society. And those goalposts are moving." ⁽²⁾

Sustainable returns

The financial services industry has reached a tipping point. Wealth management giant Blackrock, which manages some \$US6.5 trillion of funds, explains RI has moved from a 'why?' to a 'why not?' moment. ⁽³⁾

Fund managers promoting themselves as responsible investors have mushroomed both in New Zealand and offshore. Even for those not specifically promoting their funds as responsible, some form of industry screening to remove the most obvious social or environmental harm is now mainstream. Examples include companies breaching international conventions against the manufacture of cluster munitions or whaling.

The problem for fund managers is figuring out the specific harms investors most want to avoid. Fund structures pool the investment capital - and values - of a broad spectrum of investors. There are arguably as many views on what is and what is not 'responsible' as there are investors.

In theory, any constraint that limits the universe of investment opportunities has the potential to limit returns.

“

The focus of research is now moving away from identifying the wrongdoers to targeting the virtuous.

”

So the 'old view' was to ask what price investors were prepared to pay for RI in terms of investment performance.

In practice, an ever-growing body of global research and evidence supports the 'new view'; that investments screened for high rating environmental, social and governance (ESG) factors perform as well or better financially than the common herd.

Research by MSCI Inc, a global provider of market indexes and portfolio analytics tools, found companies that rated highly for ESG factors are more competitive and can generate abnormal returns, leading to higher profitability and dividend payments. High ESG companies are also better at managing company-specific business and operational risks, meaning they are less likely to suffer adverse incidents that severely hurt their share price. And they tend to have lower exposure to systematic risk factors. Therefore, their cost of capital is lower, leading to higher valuations in a discounted cash flow (DCF) framework. ⁽⁴⁾

Closer to home, a study of six years' data including ESG

characteristics looked at the Return on Capital Employed (ROCE) of New Zealand companies. This revealed a moderate, positive relationship between a high ROCE and a high ranking ESG score. ⁽⁵⁾

Screen time

The focus of research is now moving away from identifying the wrongdoers to targeting the virtuous.

In New Zealand, many fund managers employ 'negative screens' which are used to red flag the shares of companies falling foul of one or more criteria on a manager-selected list. The trouble with this approach is that simply defining companies by a binary 'good' or 'bad' can be a blunt and ineffective tool. Negative screening will run into problems of the size, scope and directness of a company's activities.

Tobacco manufacturers may be out, but what about supermarket chains deriving a material part of their revenues from selling cigarettes? If RI drives all gunmakers out of business, who will arm our police and military? And if it's not OK to make nuclear warheads, how is it OK to

make components for the rockets that deliver them?

Negative screening has been giving ground to 'positive screening', where a fund manager actively seeks out companies that have high ESG scores. This is the approach now taken by the New Zealand Superannuation Fund, which believes positive ESG investing "may be more effective than exclusionary screening for enhancing portfolio returns." ⁽⁶⁾

True to label?

To many people, portfolio screening may appear to be highly technical and best left for investment professionals to wrestle with. But as the wealth management industry snowballs in size - and with it proxy-voting power - portfolio components are attracting increasing media and regulatory attention.

A particular focus for New Zealand is KiwiSaver. Driven by generous employer contributions, tax breaks and the opt-out mechanism, membership is approaching three million and funds topped \$56 billion in March 2019. ⁽⁷⁾

Many fund managers were well and truly caught with their

pants down in 2016 when a New Zealand Herald article delved into the holdings in their KiwiSaver funds. Managers scrambled to adapt by adopting negative screens as the public watched. The regulator is now watching closely too.

“Sustainable investment funds must stay true-to-label or risk regulatory intervention,” Robert Sloan, FMA’s capital markets head of disclosure told the Responsible Investment Association of Australasia New Zealand conference in September last year. “Even if we think it’s close to misleading, we will intervene. If it looks cute, we will want to have a chat.”⁽⁸⁾

Technology is helping, making it easier for individual investors to decide for themselves by

checking out what’s held in the fund they invest in. Mindful Money, for example, is a tool for examining what securities a KiwiSaver provider holds in ‘areas of concern’ as identified by the Responsible Investment Association of Australasia’s consumer surveys.

In the absence of any simple clear way for fund managers to do the right thing, the best position for the New Zealand wealth management industry to take is ‘what you see is what you get’. But to make that claim, all managers must make it very clear exactly how their responsible investment approach works and what they will (and won’t) invest in. Transparency is everything - and the industry’s nowhere near there yet.

John Berry is co-founder and chief executive of Pathfinder Asset Management, an ethical investment specialist. Pathfinder is also manager of the CareSaver KiwiSaver Scheme.

This column provides general information only and no recommendations to acquire or dispose any financial product. Investors should seek professional financial advice appropriate to their individual circumstances before making investment decisions.

Since John wrote this article the FMA issued a Consultation Paper for “proposed guidance on green bonds and other responsible investment products.” Submissions close on 24 October 2019.

1. Global Sustainable Investment Alliance, Global Sustainable Investment Review 2018
www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf
2. www.fma.govt.nz/news-and-resources/speeches-and-presentations/nz-capital-markets-forum/
3. www.blackrock.com/corporate/literature/whitepaper/bii-sustainable-investing-may-2018-international.pdf
4. MSCI, Foundations of ESG Investing, November 2017
www.msci.com/documents/10199/03d6faef-2394-44e9-a119-4ca130909226
5. www.armillary.co.nz/wp-content/uploads/2019/06/2018-ROCE-Report-final.pdf
6. nzsuperfund.nz/sites/default/files/documents-sys/White-Paper-ESG-Beliefs.pdf
7. www.fma.govt.nz/assets/Reports/KiwiSaver-Report-2018.pdf (member numbers), investmentnews.co.nz/investment-news/kiwisaver-recovery-not-complete-but-up-4-5bn-in-march/ (FUM March)
8. investmentnews.co.nz/investment-news/fma-has-cute-warning-for-greenwashers-global-regulatory-pressure-mounts-on-esg-disclosure/



A scenic landscape photograph showing a large bay with turquoise water, surrounded by rolling green hills and mountains. The foreground features lush green grass and scattered trees. In the distance, a small island is visible in the water. The sky is a clear, vibrant blue. A vertical green bar is positioned on the right side of the image, containing the word "Contributors" in white text.

Contributors



Beckie McClelland

**Head of Wealth Management,
Director, Risk Consulting KPMG**

E bmccland@kpmg.co.nz

T +64 9 363 3273

Beckie works alongside banking, insurance and wealth clients with a particular focus on the funds management and financial advice sectors. Beckie has 20 years' experience in financial services in New Zealand and the United Kingdom, working across client-facing, risk, compliance and governance roles.



Matt Prichard

Partner, Audit, KPMG

E matthewprichard@kpmg.co.nz

T +64 9 367 5846

Matt helps lead work with Māori, and a range of advisory and audit work for financial institutions. He has held a number of client-facing and leadership roles and his current clients include a number of New Zealand's largest financial institutions.



Mike Clarke

Partner, IT Advisory, KPMG

E mikeclarke@kpmg.co.nz

T +64 9 363 3507

Mike leads KPMG's IT Advisory Practice and works with clients to transform their IT to deliver improvements to people, process and technology. Mike has led technology businesses and divisions of large corporations across Australia and New Zealand.



Rachael Pettigrew

**Associate Director, Internal Audit
and Risk Consulting, KPMG**

E rpettigrew@kpmg.co.nz

T +64 4 816 4548

Rachael is a risk professional who is passionate about helping clients focus on achieving their strategic objectives. She works with Executive Leadership teams to demonstrate how they can optimise their decision making through effective risk management.



Rob Everett

Chief Executive, Financial Markets Authority

Rob is the Chief Executive of the Financial Markets Authority (FMA). Originally from the United Kingdom, Rob has experience in investment banking, legal and risk management.



John Berry

**Co-founder and Chief Executive, Pathfinder
Asset Management**

John Berry is co-founder and chief executive of Pathfinder Asset Management, an ethical investment specialist. Pathfinder is also manager of the CareSaver KiwiSaver Scheme.







This publication has been printed on paper which is FSC certified. The pulp from this paper has been sourced from a well managed forest.