FINANCIAL & BUSINESS SERVICES

CAN DIGITIZATION TURN COMPLIANCE INTO A COMPETITIVE ADVANTAGE?

Whitepaper
EXECUTIVE SUMMARY

More than 80 regulatory reforms have been passed since the global financial crisis began in 2008 – and they are touching areas of financial services that weren’t affected before – such as Product Management. Regulations like the Alternative Investment Fund Manager Directive (AIFMD), Packaged Retail and Insurance-based Investment Products (PRIIPS), the Markets in Financial Instruments Directive II (MiFID II) and the Dodd-Frank Act are demanding more transparency, reporting and collaboration in the design and sale of financial products. At the same time, the UK’s Financial Conduct Authority requires financial institutions to respect Conduct of Business (COB) rules that provide detailed guidance on how staff and representatives of regulated businesses should deal with customers.

Many institutions are finding that their traditional product management processes need to change. But how can they turn regulatory compliance into a competitive advantage?

Businesses in other regulated industries like aviation, life sciences and the automotive industry have been using digitization – the integration of digital technologies throughout the business – to automate processes to improve governance and compliance, increase efficiencies and reduce costs. Financial institutions are beginning to realize they can benefit from the experience of these other industries to harness digitization and achieve their goals.

Dassault Systèmes has helped organizations in the life sciences, aviation and automotive industries to thrive in the face of regulatory scrutiny for more than 30 years. Now it has brought that experience, knowledge and expertise to financial services.

THE PRODUCT GOVERNANCE CHALLENGE

Product governance is at the heart of the new regulations, which demand transparency, customer-centricity and the harmonization of processes across business units and geographies. Institutions that create and distribute financial instruments must now prove they’re acting in the client’s best interests throughout the product lifecycle.

But many organizations are still working with disjointed technologies and processes across departments and geographies. Their product management relies on manual processes that hamper collaboration, innovation and product governance.

This challenge extends across the entire product lifecycle. By addressing it, institutions can improve processes, control costs, enable customer-centric innovation and ultimately achieve competitive advantage.

HOW CAN THE CHALLENGE BE ADDRESSED?

Regulatory compliance and product development are data-intensive processes. Digitization and automation throughout the product lifecycle are key to unlocking these challenges while maximizing the opportunities.

“Implementing the regulations is not complicated from an IT perspective,” says Daniel Veit, in charge of MiFID II projects in relation to impact on product management for wealth management and private banking at Deutsche Bank. “But amending the antique IT infrastructure that exists in most institutions is a real burden for all regulatory projects. This is an area where institutions need to invest.”

CONSTRAINT OR CATALYST?

It’s tempting to view new regulations as a burden. But for some financial institutions they provide an opportunity to improve governance, processes and innovation. “Of course it is a burden, but we have to remember that most regulation is a reaction to market failure,” says Veit. “We shouldn’t be too reluctant to implement new requirements, but we should be willing to question them and identify what’s reasonable.”
Trevor Goodman, Head of Legal at Legg Mason, noted that in a post-2007 environment of intense margin and cost pressures, institutions are already focusing on the type of products sold and the number of external partnerships. So are the regulations simply accelerating the pace of change?

Certainly for some institutions, new regulations are acting as a catalyst to help realize long-held ambitions. “MiFID II is a catalyst to enhance the quality of services because it promotes faster development of services we have wanted to provide for many years but haven’t prioritized,” says Angélique Angervall, who heads the group-wide implementation of MiFID II and Insurance Distribution Directive (IDD) at Swedbank. “With any regulations, when you close the door you open a window. It’s often our natural instinct to protect what we have, but we need the courage to let go and try something different.”

**APPLYING EXPERTISE FROM OTHER REGULATED INDUSTRIES**

Financial Services is a highly regulated industry, and the regulatory burden is expected to increase. Other regulated industries, such as life sciences, have long experienced detailed inspections, reviews and approval processes. The expertise gained in these other industries can be invaluable to financial services institutions.

Kevin O’Leary, the founder and CEO of Qumas, a leading life sciences compliance consultancy and software provider, recently acquired by Dassault Systèmes, compares synergies between the two industries. “From a product management point of view, both industries have an obligation to react to changing market dynamics, strategic intent, and especially regulatory update. In both industries, bringing products to market involves different regulators with different agendas causing significant burden on the product management side.”

But these industries typically use different product development processes. “Life sciences organizations have developed mature, scalable and repeatable processes to get products to market,” says O’Leary. “Financial product development tends to be looser, localized, non-scalable, non-repeatable and highly dependent on individual pockets of expertise. But in an intensifying regulatory environment, financial organizations can benefit from embracing the scalability and repeatability that prevails in life sciences.”

Key steps in both industries include identifying and tracking industry and geographical regulations, appropriate and timely training and certification of employees on those regulations, applying the regulations to the relevant products and markets, defining target markets, capturing and reusing ideas, keeping track of progress, enabling continuous dialogue with distributors, monitoring customer queries and complaints, and finally being able to prove to regulators that decisions are always taken with an appreciation of the product’s suitability for the customer’s interest and profile.

Digitization is essential to these processes, especially in the face of regulatory changes. “Automating these processes can significantly reduce time to market and bring certainty to the steps and timing of the process while allowing variation and changes to products and services,” says O’Leary. “It enables a cycle of rapid review, approval and release, allowing organizations to bring more products to more markets faster, with greater certainty.”

**CAN BETTER COLLABORATION IMPROVE GOVERNANCE?**

Financial institutions usually consist of separate business units that focus on their own products, geographies and processes, often using separate IT systems. But harmonized product development processes are essential for meeting MiFID II and for COB requirements. To ensure good governance, collaboration across teams must be part of a controlled, process-based culture which maximizes accountability and transparency across the organization.

Changing habits is a long-term project, says Veit. “Change happens slowly because it’s about developing habits. People have to get used to thinking about the target market or ensuring more detailed cost transparency, and they have to think about what that will mean for product management. Training and qualification of staff is crucial.”

Digitizing the product lifecycle can speed up that process, and it’s essential to establishing a standard across teams, product types and geographies. By automating processes and providing enterprise-wide collaboration tools, organizations can enable individuals to work together on a product in real time. They can improve efficiency and governance, enabling ideas to be captured, reused and repurposed for future iterations and product approvals.
Harmonizing processes can also reveal synergies between departments, says Angervall. “The requirement to harmonize processes should be good from a return on equity, cost efficiency and compliance perspective, and it will save us time because we know the same processes are being followed. To implement optimization across the organization you need to inspire people from different business areas, countries and product teams to cooperate and think bigger. At Swedbank, we asked ourselves whether we could apply our approach for other purposes outside MiFID. We realized we may be able to close down an older excel system that we don’t need anymore.”

**CAN THE INDUSTRY FIND A COMMON LANGUAGE?**

MiFID II requires the manufacturers and distributors of financial products to work closely together and exchange large volumes of information about the target market. This involves a target market standard definition as well as a consistent and efficient approach to approving sales for all products, sold with or without advice. To meet regulatory and COB requirements, organizations need to gather information about the client’s financial knowledge, needs and objectives to ensure they’re selling the relevant product to the right person. That adds up to a lot of data.

Lack of clarity on this information exchange requirement is causing headaches. Guidance from the European Securities and Markets Authority (ESMA) suggests that manufacturers only need an abstract understanding of the target market, while distributors need a more granular view. Goodmann said this raises important questions. “How much detail do manufacturers need from distributors about products sold outside the target market? How can institutions use data about individuals the way they need to while complying with data protection regulations? And what are the cost implications of exchanging large volumes of detailed information?”

To keep on top of their data, communicate with partners and ensure governance throughout the product lifecycle, organizations require sophisticated automation and data analysis capabilities. “Automation is needed when huge volumes of information are involved, this is not something that can be done manually,” says Veit. “In the future we’ll have to ensure any financial instrument our clients order, even online, is approved. We’ll do that through an automated approval process combined with data checks to verify that all relevant products have available a prospectus, a risk class, and are approved for distribution in Germany. We will also include MiFID II data such as cost information and target market information. If any of these data points is not available we will not approve the product.”

**HOW IS REGULATION AFFECTING THE PRODUCT UNIVERSE?**

The requirement for close collaboration between manufacturers and distributors also raises questions about how those roles are defined – and the answer could affect product development.

Veit says that Deutsche Bank currently plays a co-manufacturer role in the development of products it distributes – but this will have to stop under the new regulations. “We tell manufacturers what kind of product we want, the market they should cover, how fees should be embedded and how much it should cost. These activities are all meant to be covered by the manufacturer, but we want to avoid that role. Being a manufacturer would give us responsibilities which, as a distributor, we don’t want.”

A smaller, simpler product universe is the likely result. Goodmann noted that as organizations face commercial pressures to push their own products and restrict the number of funds they sell from providers, many global players may look to reduce the number of partners they’re willing to work with. This could lead to changes in the number and types of product sold, and help to accelerate trends to cheaper, passive products and exchange-traded funds. That means that asset managers need to work harder to justify the products they recommend and prove that they are true active managers.

Angervall believes financial services is on the cusp of a similar transformation to the one seen in the air travel industry – one that saw expensive, complex, all-inclusive tickets being replaced by a simpler, itemized and more transparent model that lets the customer compare prices and pay only for the services they want. According to Angervall “The industry is at the beginning of that curve as a result of the failures of the past and the regulatory environment that has evolved since.”. “Some of the old, complex products and services may disappear but we’re going to see new products and new business models.”
This will be accompanied by an increased focus on branding and marketing investment solutions as financial institutions seek to differentiate their offering. Meeting regulatory requirements on product suitability will also bring opportunities for institutions to market investment solutions as experiences, ensuring consistency in the process.

The products may be simpler, but organizations will need to respond quickly to client needs. Many institutions provide a digital interface with the client, but true responsiveness can only be achieved when product and solution innovation is part of a digitalized product lifecycle, enabling more efficient product development with better governance built in.

**HOW CAN INSTITUTIONS ENHANCE PRODUCT VALUE?**

Another key driver for simplified products is the requirement to enhance value. As institutions collect volumes of information about their clients, their insights are likely to change the way they think about asset allocation. “Understanding the customer better will lead to more client-centric products, or more products which fit better to real client needs,” says Veit. “We need to move away from an asset-class logic to a solution-based logic based on client needs and objectives. Clients don’t necessarily need corporate bonds; they need a return, whichever asset class it comes from.”

There is lack of clarity from regulators on what ‘added value’ means. But Angervall says that visibility on performance can make a major contribution – and automated product lifecycle management is a key enabler. “Performance reporting could be one quality enhancement that enables the client to see their whole portfolio and the development of their investments. We’ve wanted to do this for many years but we thought it was impossible because we had so many systems in place. Now we have the system in place to make it possible.”

But Veit warns that requirements to provide comprehensive information about products could add complexity for clients. “We can’t reduce the volume of information the client will get such as the product description, cost transparency and the suitability statement,” he says. “The question is, will clients read it or forget about it? When you sell a car you’re selling the driving experience, not a set of wheels, an engine and so on. That’s something we need to achieve with financial products. What is important is the effect it will have and whether that effect is clearly described.”

With the ex-ante cost transparency sheet in their hand, clients will also become more critical about how those products perform – making value enhancement a key concern in product development.

**CONCLUSION**

An increasingly regulated environment means changes to product management processes for financial institutions. Requirements such as defined target markets, product approvals for non-advised business and changing risk classes will generate new tasks and processes that must be consistent across the organization.

But institutions are also seeing opportunities to turn regulatory requirements into competitive advantage. Superseding a traditional approach with repeatable, automated product lifecycle management has the potential to accelerate fund development and better manage business processes and costs. With stronger collaboration enterprise-wide across geographies, requirements to enhance value and provide more individualized advice are encouraging simpler products while fostering greater customer-centric product management across umbrellas, funds and share classes.

Digitalization is an enabler of these changes. As companies in other regulated industries have shown, by improving process automation, product managers can increase compliance and governance, reduce costs, improve efficiencies and strengthen internal and external collaboration. Repeatable processes and improved corporate memory free up time to improve the customer experience.

Dassault Systèmes has brought more than 30 years of unique knowledge from the life sciences, aviation and automotive industries into financial services. By putting that expertise to work, financial institutions can strengthen governance and compliance with the efficiency and repeatability to support collaborative and customer-centric innovation.

To find out more, visit [https://www.3ds.com/industries/financial-and-business-services/innovation-factory](https://www.3ds.com/industries/financial-and-business-services/innovation-factory)

---

“Some of the old, complex products and services may disappear but we’re going to see new products and new business models”

Angelique Angervall, Program Manager MiFID II & IDD, Swedbank
Our 3DEXPERIENCE® platform powers our brand applications, serving 12 industries, and provides a rich portfolio of industry solution experiences.

Dassault Systèmes, the 3DEXPERIENCE® Company, provides business and people with virtual universes to imagine sustainable innovations. Its world-leading solutions transform the way products are designed, produced, and supported. Dassault Systèmes’ collaborative solutions foster social innovation, expanding possibilities for the virtual world to improve the real world. The group brings value to over 210,000 customers of all sizes in all industries in more than 140 countries. For more information, visit www.3ds.com.