



Compliance by Design



Compliance by Design involves embedding assurance testing procedures into products at the design stage: enabling firms (both existing and new entrants) to identify instances of consumer detriment from launch and throughout the entire product lifecycle.

The financial services sector is experiencing a surge in digitalisation which is transforming the way products and services are delivered to consumers. Consumer behaviour trends have accelerated due to the impact of disruptive competitors and COVID-19, with many financial services firms providing new products and solutions in a bid to respond quickly.

However, regulatory expectations around managing consumer protection risk remain unchanged: firms must ensure fair and consistent outcomes for their consumers throughout the product lifecycle. Poor consumer outcomes may arise when Product Oversight and Governance requirements are not captured as part of the product design due to the rush to innovate. A robust Compliance by Design approach enables firms to keep Product Oversight and Governance requirements in check as they deliver on their transformation agenda.

The Why

While new technologies such as instant payment solutions or cryptocurrencies may require specific consumer protection measures, there are a number of common challenges across all product types. Compliance by Design helps firms address challenges across a number of areas, such as those laid out below.

Product Issues

- Reputational damage is being caused by conduct failures across the financial services market, causing consumer detriment and undermining confidence in firms in Ireland. There is a trend of firms incurring **significant expense** related to remedial measures, which additionally **reduces consumer trust** and leads to hesitancy in the uptake of new products and services; and

- Bringing new products and features to the market often results in risk-accepting system limitations, leading to future operational inefficiencies and problems. Additionally, Products driven by algorithms / artificial intelligence (“AI”) are bringing **new risks** and **changing the way existing risks could materialise**, for example by repeating, amplifying or contributing to biases that programmers may not be fully aware of. The Central Bank of Ireland (“CBI”) recently identified **weak practices** with regard to the governance, testing and control of algorithmic trading, including a lack of appropriate detail surrounding testing methodologies.



Heightened Regulatory Expectations

- Regulatory direction (e.g. European Banking Authority guidelines on legislative and non-legislative moratoria on loan repayments) in response to COVID-19 has highlighted the requirement for an agile approach to addressing consumer protection risk in the face of **rapid and / or unexpected changes to consumer behaviour**. The upcoming introduction of the new Individual Accountability Framework, which includes the Senior Executive Accountability Regime ("SEAR"), will require increased accountability and reporting for leaders within firms;
- Scrutiny on pricing practices (e.g. CBI Differential Pricing Review, CP116, Payment Protection Insurance) in the financial services sector has increased the focus on **transparency** and appropriateness of consumer charges. Consumers should be enabled to compare products and find more cost-effective options to meet their needs; and
- Regulators set a high barrier for **new entrants** to the market. Running automated compliance checks in advance of and from the date of entry will provide comfort to Regulators and product owners that any potential issues will be identified and corrected without delay.

Manual Assurance Limitations / System Issues

- Manual assurance approaches underpin existing business models. Existing assurance models **tend to lack end-to-end oversight and focus on testing narrow sub-sets** of the full consumer population in an attempt to detect instances of consumer detriment. Consumer detriment may

therefore remain undetected until it reaches a critical mass;

- Multiple **legacy systems**, that lack comprehensive documentation, are operating within a complex IT environment which is deterring firms from taking a consolidated approach to Product Oversight and Governance. Firms are struggling adapt their systems to catch up with market-wide changes, such as the introduction of negative interest rates and transition away from Interbank Offered Rates ("IBOR"); and
- Data collected across the product lifecycle has not yet been fully harnessed for assurance purposes. Firms are **struggling to integrate automation** into their assurance procedures, reducing full-time employee ("FTE") productivity as a result of task inefficiencies.

Key Considerations and Benefits

Compliance by Design entails moving from a reactive approach to one that demonstrates a proactive and preventative strategy to consumer protection risk. This involves first defining good consumer outcomes and aligning these to the consumer value proposition. In turn, these outcomes are tied to product performance expectation metrics, compliance requirements and where possible, automated assurance tests. Where assurance testing is embedded from product design, instances of consumer detriment can be identified from the date of launch and into the future, encompassing the entire product lifecycle.



Below is a summary of some of the key considerations and benefits of building a Compliance by Design approach into Product Oversight and Governance arrangements for new products and features:

Key Consideration	Benefits of Compliance by Design
<p>Consumers and regulators expect products to take consumer objectives, characteristics and interests into account.</p>	<p>Ensures products are inherently consumer-centric, with good outcomes for consumers and firms defined and agreed prior to the build of detailed product specifications.</p>
<p>The relationship between lines of defence should allow for accurate translation of regulatory requirements into product operation.</p>	<p>The risk of lack of business expertise in compliance functions or compliance expertise amongst risk owners is mitigated, by incorporating detailed compliance considerations into both the product and accompanying assurance tests.</p>
<p>Consumer expectations and product performance should be tied to Key Performance Indicators (“KPIs”) / Key Risk Indicators (“KRIs”) with tolerance thresholds to trigger early warning and intervention.</p>	<p>Enables early identification of actual or potential issues from the date of launch and drives action and accountability, preventing product issues from remaining undetected for a number of years.</p> <p>KPIs / KRIs are linked to reliable data points, which facilitates a data-driven assurance approach.</p>
<p>Product rules should be designed, tested and run automatically to assess how all consumers (including those in vulnerable categories) would be affected if the product was to not perform in line with expectations.</p>	<p>Allows firms to pre-empt and react to changes and product performance failures in order to improve the customer experience. Assists with assessing impacts on vulnerable customer categories.</p> <p>Enhances the management of consumer protection risk by automating checks throughout the entire product lifecycle and across the full population, reducing FTE time spent on manual assurance procedures.</p>
<p>IT systems must be able to provide complete and accurate data on an ongoing and agile basis.</p>	<p>Limitations within IT systems or data that would impact the ability to carry out automated assurance procedures are identified and resolved.</p> <p>Eliminates corporate knowledge gaps as IT systems and data supporting a product are understood and documented from launch.</p>
<p>Known data limitations should be addressed with accompanying plans to acquire data and remediate deficiencies.</p>	<p>Promotes end-to-end oversight and transparency over products and processes, which can facilitate an improvement in the approach to data limitations that impact other areas, such as consumer and complaints analytics.</p>
<p>Regression testing should be performed to obtain comfort over existing processes.</p>	<p>Prevents legacy issues from negatively impacting the future operations of a new product, while also giving a level of comfort over the existing system.</p>
<p>An agile, risk-based approach to product monitoring and ongoing assurance procedures is crucial to prevent and detect emerging consumer detriment.</p>	<p>Increases risk visibility / detection at the earliest stage of the product lifecycle, leading to an increase in operational efficiency, as well as a reduction in the likelihood of conduct failures. The approach to Regulatory changes can be consistent, incorporating them into the product’s design.</p>
<p>Clear lines of accountability to carry out procedures and escalate potential or actual issues should be established.</p>	<p>Enhances accountability amongst peers which compliments the key aims of the Individual Accountability Framework, (i.e. SEAR). Senior Executives can be confident that they have a robust approach to controlling their product set.</p>

How can KPMG help?

Compliance by Design provides a holistic approach to identify early warnings of product issues: reducing the potential for future restitutions, increasing operational efficiencies and driving better outcomes for consumers. Firms that take the opportunity to update their approach are likely to make significant progress within their Product Oversight and Governance activities and **reduce the risk of negative outcomes for consumers**.

KPMG aims to provide firms with a comprehensive understanding of the challenges surrounding products and their underlying control environment, introducing automation and preventative controls during product design. In the current environment, **firms are striving to reduce costs**. Our approach aids this by **reducing the manual effort required** in assuring products and building data-oriented tools that place consumers at the centre of product design.

1. We understand how consumer-centric firms will look in the future. This is reflected in our Compliance by Design key considerations and benefits, which incorporate the role of assurance with a consumer-first approach. They are informed by our extensive experience of leading remediations and unique, in-depth financial products experience.
2. KPMG has worked with several firms to develop their conduct risk approach throughout different stages of the product lifecycle. We will leverage our client base to support the implementation of your Compliance by Design approach by providing insight into what peers are doing in relation to assuring their products. Our knowledge and understanding are based on a first-hand experience of working with industry peers and Regulators on their assurance programmes.
3. We will provide a core team that you can trust, with a track record of delivery and extensive experience of client focussed operating models. Our team has the right skills to mobilise quickly and efficiently, to ensure smooth and effective delivery of the project. We bring a distinctive variety of skills from product subject matter expert ("SME") knowledge, conduct and risk expertise to data analytics and applied intelligence.



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