

# MIFID II: Product Governance



## The Regulatory Landscape

- ESMA has recently launched a Common Supervisory Approach (“CSA”) on the application of MiFID II Product Governance rules, to be scheduled in 2021. This action will allow ESMA and the National Competent Authorities to assess the progress made by both manufacturers and distributors of financial products in the application of these Product Governance rules. While the ultimate regulatory approach to supervision will be influenced by the results of the CSA, it **appears there is a trend towards evaluating how firms are managing investor / consumer protection related risks.**
- Published guidelines have been in place in relation to Product Governance under MiFID II since 2017, however CSA announcements regarding the supervision of Suitability and of Costs and Fees of UCITS, make it clear that firms must act now to reinforce their Product Governance programmes. Regulatory bodies across financial services have stressed the essential role that Product Governance plays in ensuring that **clients’ best interests are placed at the centre**, with importance placed on **early and proper implementation of guidelines.**
- Of particular interest is the CSA on the supervision of Costs and Fees of UCITS. This CSA is also client-centric, with a focus on ensuring that investors are being charged fairly and are not subject to undue costs. Firms need to critically assess **how their pricing structure reflects the underlying characteristics of their target market** and in turn, how this aligns with investment objectives and expected returns. Regulators expect that this is embedded at the product design stage, coupled with ensuring that any **charges are disclosed transparently.**

## Investor Protection: Key Points to Consider

- A number of key points emerged from the recent CSAs which focused on investor protection and their underlying regulatory publications. It is envisaged that assessment criteria (such as that included in the September 2016 Themed Inspection for Structured Retail Products in MiFID authorised Investment and Stockbroking Firms and Credit Institutions) will place an emphasis on how a firms’ offering performs in some of the below areas. How these areas map to KPMG’s Bespoke Methodology for Product Governance is as follows:

	Product Governance	Costs and Fees of UCITS	KPMG Product Governance Approach Areas
<p>The charging structure should be clear, avoid unnecessary complexity and prevent undue or hidden costs.</p>	✓	✓	Product Event Mapping; Risk Control Matrix; Third Party Outsourcing; <b>Costs, Fees &amp; Charges</b> ; Complaints Analysis; Issue Management; Product Rules Testing; Product Change Testing; <b>Pricing Assurance</b> ; T&C Review; Compliance Gap Analysis.
<p>Needs, objectives and characteristics of target market are required to be considered at the outset by manufacturers and on an ongoing basis.</p> <p>Suitability Assessment requiring Firms to take all reasonable steps to ensure that a client’s investments align to their investment objectives and personal circumstances.</p>	✓	✓	Product Event Mapping <b>Target Market Analysis</b> ; Third Party Outsourcing; Costs, Fees & Charges; Complaints Analysis; Issue Management; <b>Product Change Testing</b> ; Pricing Assurance; T&C Review.
<p>Fees and charges applied to products should align to expected returns over the life of the product and be proportionate to market standards.</p>	✓	✓	Target Market Analysis; Third Party Outsourcing; <b>Costs, Fees &amp; Charges</b> ; Complaints Analysis; Issue Management; Product Rules Testing; Product Change Testing; <b>Pricing Assurance</b> ; T&C Review.
<p>Policies and procedures should be in place to assess performance in the context of clients’ interests, ensuring that clients are treated fairly.</p>	✓	✓	Product Event Mapping; Risk Control Matrix; Third Party Outsourcing; Complaints Analysis; Product Rules Testing; Product Change Testing; Compliance Gap Analysis.

## Evolving and Emerging Client Risk Profiles

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- The market is being disrupted with low or zero cost offerings which are reducing barriers to entry, particularly for retail investors. With the Capital Markets Union seeking to actively foster the participation of retail investors in capital markets as highlighted in the 2019 ESMA Annual Statistical Report, this trend will continue.
- Progress will be needed in assessing and understanding the changing structure of financial instruments as investor risk profiles evolve and increasing numbers of less sophisticated investors emerge. Getting new products and features to the market quickly whilst **avoiding potential future issues** requires significant control and **in-depth understanding of product sets**.
- Regulators expect firms to be effective, efficient and proactive to ensure issues are identified and addressed in a timely manner. While emphasis is often placed at the product design / target market assessment phases to focus on risk reduction and prevention at an early stage, firms cannot neglect the broader product lifecycle when carrying out its on-going assessment of product risk. In line with the recent guidelines and market developments, firms need to take into account how risks arise and costs accrue over time, particularly for new entrants, to ensure that a product's value proposition is not undermined.

## The Business Case: Manual Assurance and Enforcement / Remedial Action

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- Existing business models are too focussed on manual, resource-heavy assurance processes. In most cases, a multitude of **legacy systems** are in operation within a complex IT environment without comprehensive documentation and a full understanding of system processes. As a result, assurance models tend to **lack end-to-end oversight and transparency** over products, processes and interdependencies. There is an ongoing theme of **corporate knowledge gaps**, further complicated by firms' distribution models and reliance on third parties to deliver product offerings.
- Expansive use of data collection across the product lifecycle and increasing sophistication of modelling techniques have brought the role of big data and analytics to the forefront. How data plays a role in product development and control will continue to develop. Harnessing a **data-driven approach is a natural fit for product governance arrangements** to monitor product risk and action any potential or actual identified issues. Furthermore, an in-depth understanding of products enables the expedited roll-out of any changes and associated assurance (e.g. change in product offering, proposition, or emergency situations).
- Guidelines such as those outlined by ESMA build a clear pathway for Regulators to supervise, inspect and where necessary, enforce non-compliance with regulations. The growing body of regulator guidance, heightened consumer expectations and media attention on financial services all converge on a firm's product offering. A **proactive and preventative approach** will demonstrate adherence to the spirit and letter of the guidelines, while **reducing the possibility of enforcement or remedial action in the future**.

## KPMG's Bespoke Methodology

KPMG have designed a bespoke methodology to arm organisations with tools and techniques to control its product set and align with the evolving and expanding Product Governance and client protection expectations. The methodology focusses on building a comprehensive process to assure products, across the entire product lifecycle with a focus on regulatory compliance, transparency and fair treatment of clients.

The methodology is designed to provide organisations with a comprehensive understanding of its products and underlying control environment, reducing the time both first and second line spend on assuring products through introducing automation and preventative controls. In the current environment, firms are striving to reduce costs and our methodology assists by reducing the manual effort required and building data-oriented predictive tooling that provides comfort that products are operating as expected with client interests at the centre. This approach also allows firms to roll out changes in an expediated manner which is key in today's evolving environment and heightened regulatory expectations.

# Product Governance Approach



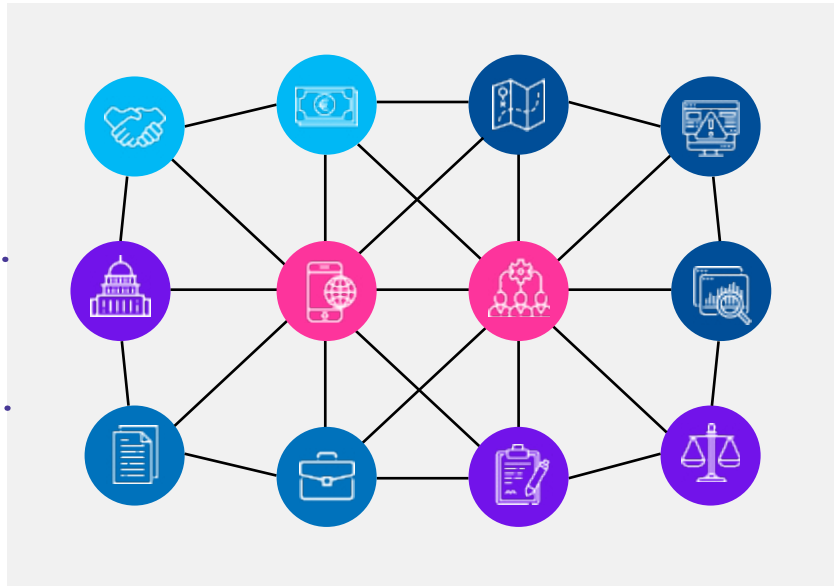
# Strategic Product Assurance

## Interaction of Events & use of NLP

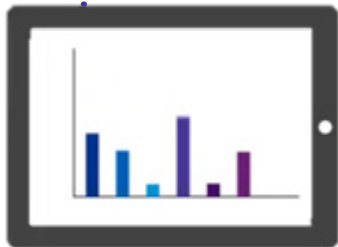
Interrogation of Data



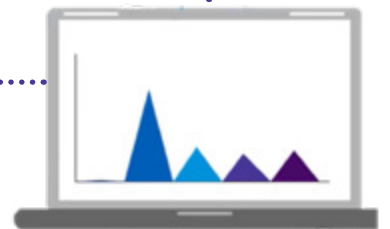
Interrogation of Data



Strategic tool



Results Visualisation



Attribute Testing

# Why KPMG?

01

We understand how client-centric firms will look in the future. This is reflected in our bespoke Product Governance Framework created by our Irish Practice; it incorporates the role of assurance for competitive advantage and is informed by our extensive experience of leading remediations and restitutions and unique in-depth financial products experience. We also have unparalleled experience in assisting our clients in enhancing various aspects of their Risk frameworks.

02

KPMG has extensive experience in conduct related remediation projects and has critical insights into the underlying root causes of conduct issues and importantly how firms can embed a suitable risk framework to prevent conduct issues arising in the future. In addition, KPMG has worked with a number of firms to develop their conduct risk frameworks both at entity levels and operating model levels, including those specific to Product Governance.

03

We will leverage our client base to support the implementation of your Product Assurance Framework by providing insight into what peers are doing in relation to Product Governance. We work closely with our colleagues in the Netherlands, UK and Australia in particular to bring our clients leading insights and direction, both from an industry and regulatory perspective.

04

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

05

We have detailed and nuanced knowledge of regulator expectations (in Ireland, Netherlands, UK and Australia) and clear understanding of industry standards for Product Governance within the financial services sector. Our knowledge and understanding are based on a first-hand experience of working with industry peers and regulators on their Conduct Risk Programmes.

## Contact us



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