



**The sensitivity of financial products  
and services to integrity risks**

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# The sensitivity of financial products and services to integrity risks

Financial institutions, including banks, insurance companies, payment institutions, trust offices and pension funds, are required to have controlled and sound business operations. This means that such institutions must have, amongst others, a solid understanding of and insight into their integrity risks. In addition to identifying the integrity risks related to its customers, a financial institution should also acknowledge the risks related to its core business, being offering financial products and services. The latter is not always the case.

Financial institutions often have already implemented proper Product Approval (and Review) Processes (PARP) which allow them to understand exactly what they offer. However, existing PARP's have varying maturity levels within the financial services industry and there is still room for improvement. The PARP aims to enhance customer protection before a product or service is launched; to ensure that a product or service offers added value for a specific client; and to avoid that products or services are not suitable ("Would I sell this product or service to a close relative?"). Until recently, products and services are usually only assessed from a duty of care and the prevention of misselling perspective and hardly from an integrity perspective. How is the full scope of integrity risks associated with these financial products or services assessed?

Any integrity risk(s) associated with a product or service that could harm the organization should refrain the institution from launching a product or service, despite its commercial benefits.

“Paradoxically, financial institutions often promote integrity, but they still neglect to assess their products and services on latent integrity risks“

## DNB Supervision Outlook 2018

The following elements will devote extra attention in 2018, which emphasizes the urgency of a comprehensive Compliance Risk Assessment, including a product risk assessment:

- Effective data-analysis
- Excluding boxticking exercises
- Use of innovating technologies
- More effective and efficient ethical operational management
- Complying with the 4th AML
- Directive requirements
- Preventing paper SIRAs
- On-site research on actual effectiveness of controls
- Adequate transaction monitoring system
- Preventing money laundering, terrorist financing and evasion of financial sanctions

### The importance of a product risk assessment

Financial institutions often have a wide range of financial products and services they offer. These products can vary from simple to complex and from execution only or products or services for which a proper advice is required. The development and offering of products and services is often driven by commercial strategy and competitive pressure without taken the actual and latent integrity risks properly into account. Besides that, product and service descriptions may become outdated when products and services and their customer use develop in time.

Existing more qualitative PARP processes fall short in revealing the full scope of integrity risks and they do not take the actual effectiveness of controls into account. Therefore it is essential that institutions start or keep assessing their products and services systematically and data-driven against current (external) trends and actual customer use.

“What are these integrity risks and how can they be assessed for each product and service?”



### Key integrity risk areas

Although duty of care and misselling can be seen as integrity risks, many financial products and services expose the institution to a broader range of integrity risks. They may inherently also be ideal for money laundering, phishing, fraud, terrorist financing, cybercrime and/or tax evasion.

The question is whether financial institutions are sufficiently able to mitigate these risks by means of effective controls. The regulator requires institutions to have a solid understanding of and insight into these risks related to their broad product portfolio and financial services, and that they systematically analyze and monitor them on a continuous basis.



**Products risk assessment methodology**

A solid and effective product risk assessment methodology consist of three phases:

**Preparation:** In this phase the scope of the risk assessment is defined. The institution compiles a list with its current and offered financial products and services, including the quantity of each product. External developments must be taken into account and a generic set of risk criteria (indicating how financial product or service can be misused) is defined.

**Risk Analysis:** In the risk analysis phase the inherent risks of each financial product and service are assessed, how these are supposed to be mitigated by existing controls, and what potential residual risks still exist after controls have done their work. Finally, mitigating measures must be defined to reduce these residual risks back within the boundaries of risk acceptance.

“Solid and comprehensive compliance risk management will ultimately reduce the likelihood of a major non-compliance event or ethics failure”

**Some examples of financial products and services that could expose a financial institution to integrity risks:**

Investment products	Online sale
Cash transactions	Asset management
Real estate services	Annuity investment account
Trade finance services	Innovative products
Trust services	Life insurance
Combination product	Credit cards

**Closing:** The results of the risk analysis must be reported and proposed measures must be followed up and monitored.

Subsequently, the output of the product risk assessment should result in an enhancement of the overall systematic integrity risk analysis in which high risk products play an important role.

### What you achieve with this approach

A solid and effective product risk assessment shall:

- Provide you with a clear understanding of and insight into the actual risks associated with the financial products and services you offer;
- Make you aware of the actual effectiveness of your mitigating controls;
- Allow you to improve and keep grip on product descriptions, product approval and review process for both new and existing products and services;
- Help you to recognize the integrity risks of new external developments in a world of innovation and accelerated growth of new financial products and technology; and
- Allow you to strengthen and to underpin the risk classification of your customers since you know the integrity risks related to products and services offered to certain customer types.

Financial products and services are the basis of the institution's business model. For that reason these products and services should not be offered without knowing their actual integrity risks.

### How data-analytics can help you in gathering a completer insight

Data-analytics allows you to execute a product risk assessment in a smarter and more effective way. Taking all statistics into account and connecting them shows you the bigger picture of latent integrity risks for each product.

Statistics, mutations, frequency and numbers related to the following elements can help you to create this bigger picture:

- Suspicious Activity Reports
- True hits and/or alerts
- Client risk assessments
- High risk clients
- High risk industries
- Product monitoring
- High risk delivery channels
- Product expansion per client
- Fraud investigations
- Cyber incidents
- Transaction monitoring
- Product geography
- Age of the customer.

For instance:

- High risk products and services often provided to high risk clients
- Type of products and services often occurred in Suspicious Activity Reports or cyber incidents
- Mutation of products within a short time frame
- Monitoring product and service characteristics; what can be expected in product or service use and what can be deemed unusual in terms how a product or service is actually used

### What Do You Need?



#### Financial Product Analysis

By analyzing financial products and services you discover their nature and characteristics but also gain understanding in their weaknesses. To perform this analysis you need solid product descriptions and sufficient data of the financial products and services offered.



#### Specialists

Both the analysis of financial products and the product risk assessment itself require specialists (from both first and second line of defense) regarding the financial products, the mitigating controls (testing), the execution of an effective product risk assessment, and the risk criteria.



#### Proper Monitoring

A product risk assessment is only effective when a proper monitoring is in place, which should ensure an adequate achievement of the proposed mitigating measures.

“Provide us with the figures and we do the math; the product risk assessment as a Managed Service”

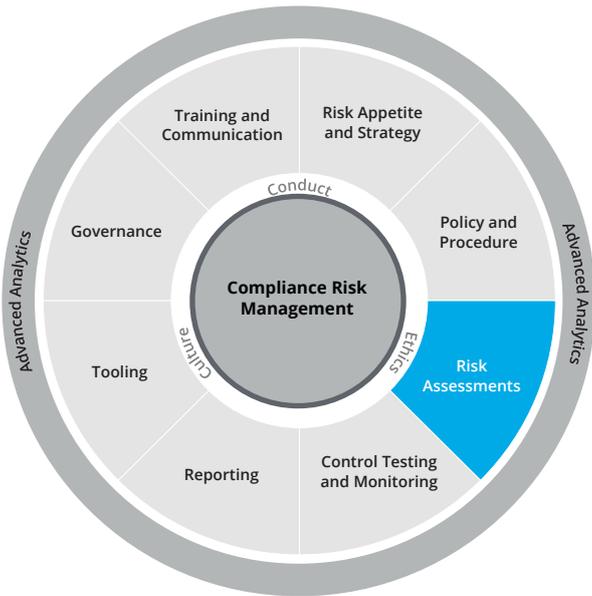
#### We Can Help...

With our broad experience with product risk assessments and knowledge of the financial market we can help to execute a solid and effective product risk assessment.

We have developed a good understanding of risk criteria and we know how financial products may expose your institution to integrity risks. We are familiar with required mitigating controls and how they are supposed to work.

#### Your product risk assessment as a Managed Service

Do you experience a product risk assessment as a burden? Let us coordinate and perform your product risk assessment as a Managed Service. The only thing you need to do is provide us with the right figures and we do the math, resulting in a solid report-out to act on.



This product risk assessment methodology is part of **Deloitte's Compliance Risk Management Solutions for 2018** which aim to enhance and ensure financial institution's Compliance Risk Management frameworks.



## Contact

Please contact us to discuss the possibilities of this method for your organization.



### Jeroen Jansen

**Partner Risk Advisory/  
Financial Services North West Europe Leads**

Email: Jerojansen@deloitte.nl

Phone: +31 (0) 6 100 426 56



### Martin Eleveld

**Partner Risk Advisory/  
Financial Services**

Email: MEleveld@deloitte.nl

Phone: +31 (0) 6 232 451 59



### Tjeerd Wassenaar

**Partner Risk Advisory/  
Corporates**

Email: Twassenaar@deloitte.nl

Phone: +31 (0) 6 129 967 20



### Christiaan Visser

**Director Risk Advisory/  
Lean Compliance**

Email: Chvisser@deloitte.nl

Phone: +31 (0) 88 288 54 28



### Hassan Bettani

**Director Risk Advisory/  
Insurance**

Email: Hbettani@deloitte.nl

Phone: +31 (0) 6 820 123 60



### Joes van Berkel

**Manager Risk Advisory/  
Compliance risk management**

Email: JovanBerkel@deloitte.nl

Phone: +31 (0) 6 109 990 27

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