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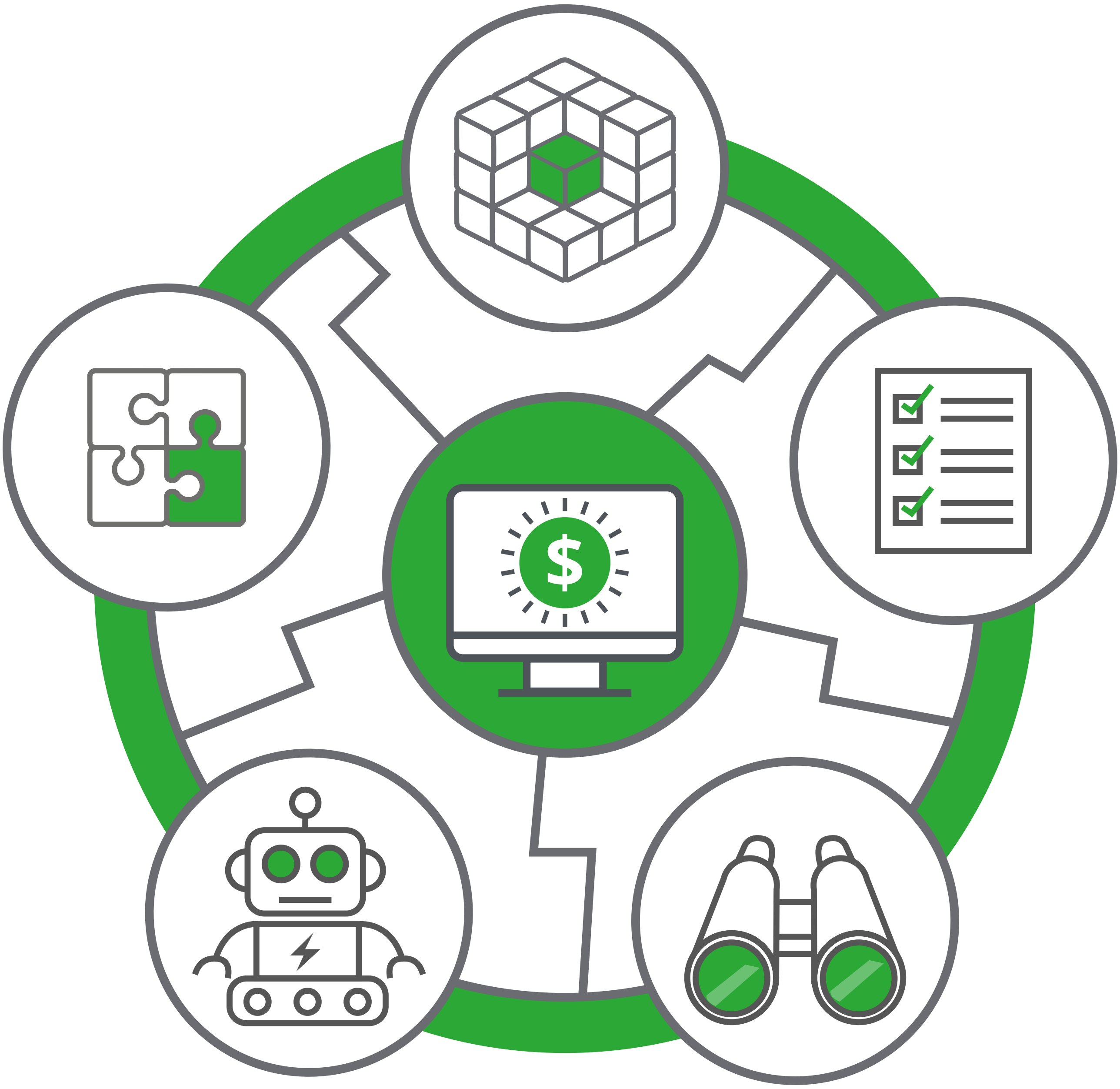


Backing up the digital front

Digitising investment suitability

Delivering good customer outcomes

For private banks and wealth managers, investment suitability is a hot regulatory topic and should be at the heart of front-office digitisation efforts. Increasingly, supervisors are expecting private banks and wealth managers to strive for good customer outcomes and demonstrate that their decision-making processes are centred on an understanding of customer needs.

Recent regional developments include the introduction of regulation on the offline distribution of complex products by the Hong Kong Monetary Authority in October 2018, and the Financial Service Agency of Japan's Principles for Customer-Oriented Business Conduct, which were finalised in March 2017.

Although regulatory specifics differ between jurisdictions, the underlying fundamental principle remains consistent: an investment product ought to be aligned to a customer's risk profile and appetite, and can be assessed through a five-stage investment suitability process. In instances where the product is considered to be unsuitable, such as where there is a high probability of unacceptable losses, the obligation is on the banks to control the selling process and protect the customer.

Five stages of the investment suitability process

Client profiling
The first stage entails understanding the client's risk profile and appetite. This is typically assessed through the use of an IPQ that covers details such as the client type, investment objectives, risk appetite, investment time horizon, and other key client metrics.

Product profiling
The second stage entails understanding the product's risk profile. This includes assessing the associated risks of each product type, including its time horizon, liquidity characteristics, counterparty risks, investment objectives, as well as other special features.

Matching
The third stage focuses on assessing the suitability of a product for a specific client to ensure that the client's risk profile matches the product's risk profile. If these do not match, the focus then shifts towards mitigating the risk through appropriate disclosure or acknowledgment from the client of a mismatch.

Disclosure
At this stage, the client is informed about the risk of the product. If a risk mismatch has been identified in the previous stage, there may also be a requirement for the client to acknowledge that they accept the mismatch.

Maintenance
As market conditions and circumstances evolve, there is a need to put in place the necessary controls and ensure ongoing and regular assessments of the suitability of products to clients.

Matching a product to a customer's needs is the core requirement

For private banks and wealth managers, the regulatory pressures are pushing players to adopt a more proactive stance where a deep and ongoing understanding of the customer drives the selection of investment products. To do this, private banks and wealth managers have to address five key themes, each posing their own unique set of opportunities and challenges.

Theme #1: Enabling effective client suitability assessment

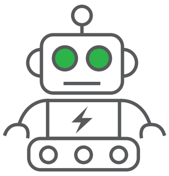
In order to enable effective client suitability assessment, the development and rollout of an Investment Profile Questionnaire (IPQ) during the client profiling phase (see "Five stages of the investment suitability process") will need to take into consideration the volume of information that is required for an operating model to apply across different jurisdictions, where requirements on data capture may diverge. An effective IPQ is one which supports a single operating model where client information can be compared across various client segments and jurisdictions to build a deeper understanding of client risk appetites and corresponding product suitability.

Theme #2: Building a comprehensive product data suite

Building a comprehensive product data suite is critical to ensure that product attributes are consistently captured across locations and asset classes, while facilitating better comparability between different product types, and enabling private banks and wealth managers to offer a better range of products to their clients. Although more complex asset classes may present challenges in terms of data sourcing, effective data laddering can also help to overcome some of these issues.

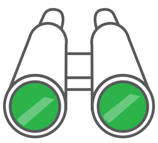
Theme #3: Customising product offerings

Technology is a key enabler for private banks and wealth managers to offer their clients customised product offerings. By matching data from the client profiling and product profiling stages of the process (see "Five stages of the investment suitability process"), private banks and wealth managers can obtain greater client insight across multiple parallels and offer enhanced product offerings that are customised to their client's requirements.



Theme #4: Standardisation of disclosure requirements

Disclosure requirements differ significantly across jurisdictions, with certain jurisdictions allowing the distribution of products with high risk profiles to clients with low risk profiles so long as a disclosure of the associated risk has been acknowledged by the client. The standardisation of disclosure requirements is therefore critical to ensure consistency across risk disclosures to clients. In addition, by setting up standardised platforms to automate disclosures, private banks and wealth managers can also ensure minimal disruptions to their overall sales process, while retaining a clearly documented audit trail for their future reference.



Theme #5: Ensuring consistent data capture

Consistent data capture protocols across the entire suitability process is crucial to facilitate ongoing monitoring and assessment to ensure that there remains a suitable match between a client's risk profile and a product's risk profile, even as both continually evolve. This requires the use of analytic platforms that are capable of efficiently consuming and assessing data. In contrast to legacy platforms where single position assessments were the focus, new technological platforms now enable first and second line controls to move beyond sample-based analysis, enabling private banks and wealth managers to leverage entire sets of data for greater accuracy and more comprehensive oversight.

Ultimately, regulators will not only be watching investment suitability but also the delivery of good customer outcomes. Ensuring that firms are not serving the wrong types of customers is a continuing regulatory priority. Robust procedures for understanding customer identity and associations, ongoing monitoring and analysis of transactions, and timely identification, and escalation and action on suspicious matters continues to be top of mind for regulators.

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