Reviewing the bank’s Product Approval and Review Process

Introduction
Recently the Joint Committee of the European Supervisory Authorities (ESAs) published the Joint Position on Manufacturers’ Product Oversight & Governance Processes, also well-known as the bank’s Product Approval and Review Process (PARP).[1]

The Joint Committee was tasked with developing a set of high-level, cross-sector principles on financial institutions’ internal product approval process. The aim is to enhance consumer protection by strengthening the process controls by manufacturers before product launch and thus discouraging products and services that may cause consumer detriment from reaching the market.

The Joint Committee provides in its publication a common, high-level agreement based on which each ESA[2] will develop more detailed provisions for their respective sectors, at a later stage anticipating new PARP conduct of business regulations to be introduced in EU Directives, markets in financial instruments (MiFID II) and insurance mediation (IMD II), and also in the context of the ongoing review of other sectorial Directives, including the business of Insurance and Reinsurance Directive (‘Solvency II’) and the Payment Services Directive.

Anticipating these new EU regulations the Dutch Minister of Finance recently introduced PARP conduct of business rules in the Act on Financial Supervision following the Banking Code of the Dutch Banking Association (Nederlandse Vereniging van Banken (NVB)).[3] So in the Netherlands, the PARP for banks is already strongly regulated since 2013, not only from a prudential but also from a conduct of business perspective.

In this article we discuss and focus on the way these new PARP rules are implemented within Dutch banks, and the problems faced by the sector and its regulators based on our own findings, opinions and research relating to implementing integrated products and services prudential and conduct of business rules especially with implementing new PARP rules by Achmea (Bank), one of the largest financial services companies in the Netherlands.

- What are the lessons learned from this Dutch experience?
- How to achieve an integrated PARP meaning to combine prudential requirements on capital and risk management with conduct of business requirements on culture, behaviour, duty of care towards clients and integrity in order to launch a new product on the market with careful consideration of the risks involved for the bank (risk management and solvency) and with careful assessment of the duty of care towards the client (conduct of business, culture, behaviour and integrity)?
- What about the role of the Management and Supervisory Board in this process?

In this article, we will deal with these questions and make recommendations.

These can be helpful to both EU banks implementing and integrating products and services prudential and conduct of business regulations and can equally help European and national legislators and supervisors introducing and supervising these regulations.

The structure of this article
First we describe the Dutch products and services prudential and conduct of business laws and regulations. Based on these laws and regulations, we explore the main products and services prudential and especially conduct of business issues to implement in the banking organisation in more depth in terms of
- scope;
- target group;
- duty of care;
- value for clients;
- training, remuneration and commission;
- researching consumer behaviour;
- review;
- culture;
- strategy;
- complaints management;
- distribution channels; and
- proper risk management.

Legal framework
Relating to self-regulation, the Banking Code of the Dutch Banking Association (Nederlandse Vereniging van Banken (NVB)) states that banking products ‘… shall not
be launched on the market or distributed without careful consideration of the risks by the bank’s risk manager and a careful assessment of any other relevant factors, including the duty of care towards the client.’ [4]

Following the Banking Code the Dutch legislator also introduces duty of care elements in the Act on Financial Supervision.[5] Banks not only have to implement Risk Management aspects based on s3:17 of the Act on Financial Supervision but also new duty of care aspects based on s4:15 of this Act. Section 3:17 (the prudential supervision part of the Act of Financial Supervision) is a copy of s4:15 (the conduct of business supervision part of this Act).

Section 3:17 as well as s4:15 states: ‘A (bank) shall organise its operations in such a way as to safeguard controlled and sound business operations.’

However, compared with s3:17, s4:15 embraces a completely different approach in implementing PARP in the banking organisation. According to s3:17, the main PARP issue is about client acceptance. Who do I want to accept? For instance: what are the risks involved for me as banker in granting a loan to client A, is the main question here. It is a solvency issue. According to s4:15, however, the main PARP issue is about adding value for clients. Which clients is the product really useful for? What is the added value that the product offers for a specific client is the main question from a duty of care perspective and also a duty of care issue.

Value for clients
In order to emphasise consumer protection, the Dutch legislator and the Dutch conduct of business supervisor (the Financial Markets Authority) introduce the PARP concept value for clients. Seen from the perspective of a bank, value for clients is related to product development and therefore is one of the pillars of the duty of care. Let us not confuse value for clients with the duty of care. Duty of care is about advising and informing clients (Diagram 1). The most important EU directives aimed at consumer protection, MiFID and IMD, are duty of care regulations, regulating the information and advice given to a specific client. As we mentioned in the introduction, the Joint Committee of the ESAs is preparing regulations for product development as well also seen from a consumer protection perspective anticipating, among others, new norms in MiFID II.

Duty of care is originally a concept pertaining to civil law. In short, it can be described as a contractor’s obligation to serve the principal’s interests with due care when performing services for the principal. In other words: know your client. And do not sell products to your clients that you do not want to sell to your mother. This obligation can also be found in self-regulation and in supervision legislation.

Goalkeeper or disclosure model?
Based on its duty of care vision, a banker informs and advises the client. For instance, a banker adhering to the goalkeeper model also protects an obstinate client and refrains from selling a product that is not in the client’s interest. This banker is a paternalist and according to this supporter of the goalkeeper model, the information he/she offers to the client is not so relevant, because the banker decides and not the irrational client.

On the other hand, a liberal supporting the disclosure model supplies all relevant information to the client with accurate, clear and non-misleading details. Eventually, the client decides and is accountable – not the banker! Of course the banker will not sell poisoned apples, but he does sell rotten apples if his client prefers rotten apples and his client knows the apples are rotten. The disclosure model is based on a liberal view about the duty of care. The banker warns his client: beware – and that is enough.

Of course in practice, offering a high or low degree of client protection is a choice in the service range that a
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1. A financial enterprise … that offers financial products … has proper procedures and measures which guarantee that, with the development of the financial product, the interests of the consumer, client and, if applicable, the beneficiary of the financial product are taken into account in a balanced way and that the financial product is demonstrably the result of this balancing of interests.

2. The procedures and measures, referred to in the first paragraph, are laid down and guarantee in any case that:
   a. the target group of the financial product is defined, with the intended goal of the target group having been analysed and described;
   b. analyses are performed in which the operation of the financial product as a whole and the individual components of it in various scenarios are recorded, and from which it appears that the financial product, in view of the nature of the product, does not affect the goal as referred to in section a;
   c. the product information and, insofar as can reasonably be expected, the distribution of the financial product is aligned to the target group, referred to in section a; and
   d. a regular assessment takes place and, if necessary, there is a suitable adjustment of the procedures and measures, referred to in the first paragraph.

3. The financial enterprise will regularly, at intervals that it determines or if there is reason to do so, apply the procedures and measures referred to in the first paragraph, on the financial products that it offers, or are combined and made available in the market.

4. If a financial product is detrimental to the interests of the consumer, client or beneficiary for whom the product has been developed, the financial enterprise will adjust the product as soon as possible, or it will cease offering the financial product, or cease combining the financial product and making it available on the market.

5. A ministerial regulation can stipulate more detailed rules concerning the provisions of the first paragraph.

6. The fourth paragraph does not apply to the management or execution of an agreement referred to in sections a, b and c in the definition of offering in art 1:1 of the Act.

7. This Article does not apply to managers of an investment fund that offer participation units in an investment fund to professional investors, managers of a fund for collective investment in securities, and investment firms'.

Article 32 Bgfo is of major significance. The foundation of duty of care for the client is formed by a proper PARP, which is an elaboration of the controlled business operations art 1:15 of the Act of Financial supervision. Uncontrolled business operations can therefore lead to compromising the duty of care. In turn, this may result in a client suffering losses. In other words: a client can sustain losses due to uncontrolled business operations of the bank from which the product is purchased.
For example: The online distribution channel with which bank X sells its product Y is unsafe because clients need advice. This means that the service provided does not satisfy art 32 of the Bgfo. Consequently, the operational management is uncontrolled, meaning non-fulfilment of the duty of care.

This example also demonstrates that PARP is not only about product but also about services a bank has to deal with. It is not just the product but rather, the proposition offered to a client (product/services combination) what matters.

Each of the various distribution channels has their own dynamics and specific usability. Until now, driver behind development of channels was cutting costs and improving accessibility. We recommend that the element of appropriateness is included into this: is it appropriate to sell this product through this (self-service) channel?

**Oath for bank’s Managing and Supervisory Board members**

Consumer protection is highlighted in the moral-ethical oath/statement for bank’s Managing and Supervisory Board members respectively introduced in 2011 in self-regulation The Banking Code followed by the Dutch Act on Financial Supervision in 2013.[7]

For example the moral-ethical oath for bank managers and Supervisory Board members states: ‘I declare that I will perform my duties as a banker with integrity and care. I will carefully consider all the interests involved in the bank, ie those of the clients, the shareholders, the employees and the society in which the bank operates. I will give paramount importance to the client’s interests and inform the client to the best of my ability. I will comply with the laws, regulations and codes of conduct applicable to me as a banker. I will observe secrecy in respect of matters entrusted to me. I will not abuse my banking knowledge. I will act in an open and assessable manner and I know my responsibility towards society. I will endeavour to maintain and promote confidence in the banking sector. In this way, I will uphold the reputation of the banking profession’. [8]

**Strong culture: what does it mean?**

The financial services industry is undergoing a transition. A transition needed to restore trust and to secure its durability and the essential part of that transition is a fundamental culture change.

We recommend that Management and Supervisory Boards initiate and monitor this change. The culture should at least entail a strong urge to develop and maintain products that ‘improve people’s life’, rather than be ‘just’ profitable.

**Introducing and implementing PARP conduct of business rules in products and services**

When introducing and implementing new products and services rules, we should be careful not to blow up the duty of care or integrity element, forgetting risk management, profit and earning model. Banking is about balanced integration of prudential and conduct of business norms. Banking intends not only to offer value to clients but also sound risk management, ensuring the bank will be solvent not only today but also tomorrow, protecting the saver.

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**Banking in products and services integrating prudential and conduct of business norms**

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**Moral compass and accountable banking**

Banking is also about dealing with different supervisors due to different supervisors being responsible, for instance, for product development processes within banks. For products and services of Dutch banks alone, at least five supervisors are involved, each creating its own products and services recommendations, including the European Banking Authority, the European Central Bank, De Nederlandsche Bank (the Dutch Central Bank), the Financial Markets Authority and the Authority for Consumers & Markets. Different supervisors involved means different points of view and approaches. There is no mechanism coordinating and integrating these different views and approaches.

In our opinion it is only at bank level that the integration of these different views and approaches will and must take place, and this is a moral compass we think could be helpful in developing products and offering services. It is not in the first place following the letter of the law and reliance on guidance. Instead, accountable banking is about internally embedding norms, integrity, the spirit of the law and professional individual responsibility. The question is not in the first place how to comply with external rules; instead, the primary consideration should be: in my opinion as a banker, what is sound and value adding banking? After all, the banker is the entrepreneur, not the legislator or supervisor.
Complying with laws and regulations is satisfying a minimum standard. It is not the same as following a moral compass. For example, think of the duty of care rules in the Dutch Act on Financial Supervision. Under this Act, you are allowed to offer services and sell products to an obstinate client who refuses to follow your suitable advice. Following a moral compass, accepting an obstinate client is not likely, because this type of client does not belong in the bank’s target group.

The PARP process itself and documentation
From our experience, it is advisable to define and describe the PARP process in detail, including documentation and approval procedures. Within Achmea a group-wide uniform PARP policy is established, and considerable effort was put into explaining the purpose and importance of this new process.

The documentation that takes place in the process is conducted with pre-defined formats in order to enhance the quality of the process. Obviously, there are numerous ways to define this process, and most of them will probably work well. However, we recommend implementing at least the following elements in the process:

- Product idea – why, where and by whom was the product idea launched?
- Risk assessment – what are the associated risks for the client and the company, how can they be mitigated and to what extend are they acceptable?
- Product paper – full description of the (new) product, including and integrating the advantages and risks for the client, company, society and a well-defined target group.
- Product file – which information will be archived (by whom) in order to be able to backtrack decisions, analysis, evaluations and market research and data related to the product.
- Product reviews – including data derived from the existing portfolio (e.g., complaints management).

Target group
Implementing value for clients PARP rules start with defining the target group of the financial product and so is in essence similar to the prospectus procedure when offering securities to the public.[9]

The target group of the financial product is the group of clients for whom the bank as manufacturer or provider is developing the product. The target group must be well defined. For example, product Y is developed for clients with an income of at least €40,000 who do not want to be exposed to interest rate risk.

Target groups, within retail banking, have been widely used over the last decade, but typically for marketing and risk management purposes. In other words: to protect and serve the interests of the bank. Using target groups and with that statistical tools to protect consumers interests are relatively ‘terra incognita’, although for an experienced banker no rocket science. Within retail banking specific target groups are described with 7–15 characteristics, containing data ranges of educational levels, income and assets, but also data as nationality, marital status, age and house ownership.

As a manufacturer, the bank is accountable for the development and issuance of a product and also for changing and combining products. Banks are not only a manufacturer but also a distributor and as a distributor, it offers and/or sells its product or a product of a third party to its clients.

It is in our opinion of paramount importance that in these cases the bank performs the same target group checks, and, obviously, takes necessary action towards individual clients to make sure that the client’s interests are protected.

Scope
In view of art 32 of the Bgfo ‘a financial enterprise … that offers financial products … has proper procedures and measures which guarantee that, with the development of the financial product, the interests of the consumer, client and, if applicable, the beneficiary of the financial product are taken into account in a balanced way and that the financial product is demonstrably the result of this balancing of interests’.[10]

In the context of the Act on Financial Supervision ‘offering financial products’ means acting as the other party in a contract with a client regarding the following financial products: an investment object; a current account including the ancillary payment facilities; electronic money; loans and a savings account including the ancillary savings facilities.[11]

Banks offer a current account, savings account, electronic money and loans. For these products banks will comply with art 32 Bgfo. Banks also provide brokerage services in insurance. For these services, we recommend banks also to comply with the PARP value added rules. The reason is that the Banking Code does not make a distinction between offering and brokerage. Furthermore, the bank, also in the role of broker, is accountable for a clear and appropriate product range. Last but not least, in the perspective of clients, banks are the ‘offeree’ also for insurance products, not just solely a broker.

PARP value adding rules, usually, are also followed in providing investment services for the same reasons.

Although business clients are not protected by the Act on Financial Supervision, they still have a duty of care desire. Therefore in our opinion, extension of the PARP rules to banking activities for these business clients is worth considering.

PARP value added rules are followed both in developing financial products and in changing existing products and services and for new marketing campaigns and advertising.

Implementing Value for clients concept
Article 32 Bgfo states that a bank ‘… that offers financial products … has proper procedures and measures which
guarantee that, with the development of the financial product, the interests of the … client … are taken into account in a balanced way’.[12]

How to implement this value adding concept? How to prove that the interests of the client are taken into account in a balanced way?

Added value is a subjective concept. Of course it is clear that a product has no added value to the client when costs exceed return. But in practice it is not so clear. Only afterwards, it is possible to prove whether or not a product has added value for a client, for instance based on favourable or unfavourable investment results.

In order to prove that a product has added value, banks have to define the target group of the financial product, with the intended goal of the target group being analysed and described and also have to use scenario analyses.[13]

Article 32(2) b Bgfo states: ‘analyses are performed in which the operation of the financial product as a whole and the individual components of it in various scenarios are recorded, and from which it appears that the financial product, in view of the nature of the product, does not affect the goal as referred to in section a’.

Basically in our opinion there are five instances in a product life cycle where a bank should perform checks to ensure that a client is still part of the designated target group:

- at point of on boarding (the moment of purchase);
- at regular intervals analysing the entire portfolio as part of the product review;
- at regular intervals analysing the ‘through-the-door-population’, to check whether marketing and distribution channels are still attracting the correct target group;
- at touch points as complaints management and contact centres; and
- in case of changes in (fiscal) legislation, economic downturns, or other mayor changes in external circumstances.

PARP issues concerning training, remuneration and commission

Article 32(2) c Bgfo states: ‘the product information and, insofar as can reasonably be expected, the distribution of the financial product is aligned to the target group, referred to in section a’.

The product information and distribution is aligned to the target group when the employees of a bank and other natural persons who are directly engaged under its responsibility in providing financial services to clients are well-trained to guarantee the quality of the financial services to the consumer or the client.

We recommend banks to conduct research among employees relating to experiences that involve centring on the client’s interest. Of course training and research alone are not enough. Added value has to be translated into key performance indicators (KPIs) and remunerations. It means employee remuneration is related to careful client handling. Are the remuneration offered to employees and the commission offered to brokers for brokerage services appropriate in order to prevent an employee or broker to advise a client to take a financial product not suitable for him/her? For instance: Broker Y receives a €5,000 commission for his brokerage services resulting in a credit agreement between client X and bank Z. So broker Y has a strong incentive to sell the loan product, irrespective of whether it suits the client X or not. That is the reason why the commission must be appropriate. An appropriate commission is a commission in proportion to the intermediaries’ activities in informing and advising consumers about a bank financing. For instance: it takes 2 hours for broker Y to inform and advise client X about bank Z financing. So the commission this bank pays is related to 2 hours of work. In order to prevent client interests being neglected in investment services and also in brokerage services in mortgage loans, life insurance products, occupational disability insurance products and payment protectors (when you lose your job or become disabled the insurance company repays the credit), it is forbidden in the Netherlands to pay or receive a commission since 1 January 2013 and 2014, respectively.

Bgfo art 58 states that variable remuneration offered to employees may not harm client interests. The remuneration rules focus primarily on combating those incentives that may give cause to taking undesirable and unaccountable risks, and which may lead to clients’ interests being neglected. The remuneration policy of a bank may cause substantial prudential and/or behavioural risks. For example, an advisor advises his client an unsuitable product in terms of cost. The reason why he recommends an unsuitable product is that this product offers a very high commission and therefore a high variable remuneration for the advisor. In conclusion this remuneration policy has an incentive leading to the negligence of the clients’ interests.

It is not suitable to base the marketer’s remuneration on volume of business. It must be based on his contribution to the bank’s value for clients.

But here we touch upon a balancing act that is difficult to address in absolute terms. Banking is in itself a business that depends on finding the optimal balance between assets and liabilities, premiums and pay-outs. The difference between profit and loss is to a larger extend determined by the banks’ ability to manage its balance sheet and associated risks. And in order to do so, volume targets (in asset or liability classes) must be achieved or maintained.

This dilemma stresses, in our opinion, the importance of a well-developed and internally well understood moral compass, as well as a solid PARP culture.

More practical, this dilemma could be addressed by carefully determining KPIs and remuneration packages. An employee that holds an advisory role towards clients should not be incentivised on products sold, but could
well be given KPIs on client satisfaction and efficiency. Because, at the end of the day, the more well advised, satisfied clients there are, the more you will sell.

Does value for clients mean that client interest dominates all other interests of the bank, including shareholder interest or employee interest? No. It does not. The reason why client interest is in the picture is to stress the vulnerability of clients in buying financial products.

**Researching consumer behaviour**

In the opinion of the Dutch legislator, consumers behave irrationally and therefore they need to be protected by saying ‘No’ when the product does not fit a consumer. But how to prove that ‘the product information and, insofar as can reasonably be expected, the distribution of the financial product is aligned to the target group.’[14]

We believe researching consumer behaviour can prove that the product fits the target group by using client panels and dialogues. Based on consumer behaviour research, questions to be answered may include:

- Is it safe to sell the product without advice?
- Does the target group understand the proposition?
- How to manage the relationship?
- How to implement the duty of care concept during the lifetime of the product?
- Clients must understand the essentials and risks of the financial product and service offered. But suppose the client does not fully understand the working of the product, but at the same time it offers the client added value – does it mean the bank is not permitted to sell the product?

**Review**

Article 32(3) obliges the bank ‘… regularly, at intervals that it determines or if there is reason to do so, apply the procedures and measures referred to in the first paragraph, on the financial products that it offers, or are combined and made available in the market’.

Reviewing the product at intervals means, first of all, to describe the reasons to review. In our opinion reasons to review the product or proposition may include changes in tax legislation or complaints about the product. In order to conduct a good and effective review process, it should be approached in a holistic manner. This means that all available knowledge should be used, all interests should be taken into account and every piece of information should be evaluated and analysed.

We recommend that in the course of a review process, at multiple instances specialists from marketing, product management, operations, compliance, risk, customer support and tax will come together and jointly evaluate available data regarding the product. Sources of data amongst others are the client and product databases, complaints management, collections management, contact centre, market research, customer satisfaction research and research around the target group.

In our view complaints management (in its wider context) is an important source of information for assessing and reviewing products. We recommend that banks integrate complaints management, market research, customer research and sales information to get a truly deep understanding of customer and market needs.

Review, in our opinion, also includes frequently discussing progress in the implementation of client centricity policy, also with the Supervisory Board.

**Introducing and implementing the integrated PARP in the bank also changes the role of its Managing and Supervisory Board**

According to art 32 (4) Bgfo: ‘If a financial product is detrimental to the interests of the consumer, client or beneficiary for whom the product has been developed, the (bank) will adjust the product as soon as possible, or it will cease offering the financial product, or cease combining the financial product and making it available on the market’.

Based on the explanatory note to art 32 Bgfo, it is the bank’s Executive Board’s task to endorse the product supervision and governance processes. The Executive Board should accept responsibility for compliance with these processes both before and after the launch of a product, and should ensure that adequate records of this assessment are maintained. Also the Executive Board holds final responsibility for adjusting the product. What does this mean for its PARP role?

Also European Banking Authority (EBA), in its Internal Governance Guideline, emphasises the Executive Board and Supervisory Board’s responsibility for PARP.[15]

According to EBA: ‘An institution shall have in place a well-documented new product approval policy (NPAP), approved by the management body (Management Board and Supervisory Board), which addresses the development of new markets, products and services and significant changes to existing ones.’[16]

In order to bear this responsibility, we recommend appointing an Executive Board member as the Chairman of the PARP Committee. Only the Executive Board can discuss PARP issues in a fully integrated and holistic context, taking into account all aspects – not only product development and marketing issues, but also strategy, legal, compliance, human resources and risk management aspects.

**Supervisory Board**

What about the Supervisory Board? Is the PARP part of the scope of attention of a specific PARP Supervisory Board member? Should he/she be the chairman of a separate PARP Committee be set up within the Supervisory Board?

Society is demanding more critical Supervisory Boards. Studies show that Supervisory Board members have made mistakes by deepening the financial crisis.[17] How did
we get to a situation in which products were marketed without adding any value for clients, and at such a major social cost? Why did Supervisory Boards not intervene? This social unrest again leads to the question of what role Supervisory Boards play in restoring confidence in banks in general, and product development in particular. What does this mean specifically for the future role that the Supervisory Boards must play in product development – the former pain point where things went very pear-shaped.

Should the Supervisory Board only examine whether the bank has a product development and review process, in a purely process-oriented role? The Supervisory Board role, however, would have more content if the Board also asks questions about the risks associated with a product. The Supervisory Board then assesses on the basis of prudential aspects or, ultimately, on the basis of the results of the ICAAP. The Supervisory Board therefore focuses on risks identified by the risk management department that are incurred when marketing a specific product and on how these risks are controlled. Product development could therefore be one of the responsibilities of the Audit or Risk Committee within the Supervisory Board.

**Thinking prospectively**

In our opinion, Supervisory Board members, however, who also think and act prospectively and not only financially, must also assess whether the product has added value for clients. The assessment is not limited to the measurement and management of the risks that they will run when marketing the product. Instead, it is more fundamental, because it is an assessment of the product against the enterprise’s own mission and the added value that the product offers to clients. PARP is not only client acceptance (risk management) and client satisfaction (marketing) but also adding value for clients.

In our opinion a Supervisory Board, which also thinks and acts prospectively in terms of value for clients rather than merely financially in terms of risk management, will be looking for answers to questions such as:

- Is the product efficient, useful, safe and reliable?
- Is our investment policy also in the interest of our clients and can it be explained?
- Do we have high-quality employees and distribution channels through which we can sell this product?
- How are they appraised and rewarded?
- Do we, as the Supervisory Board, understand the operation of the product?
- Can the Executive Board stand its ground for at least a quarter of an hour with Antoinette Hertsenberg (a consumer affairs journalist)?
- Does the end client understand the product? What is the added value? Can that not only be assessed afterwards?
- Is there a compliance culture or an integrity-aware business culture?
- Do we have a learning organisation and how are changes tackled?
- Are the statutory standards embedded internally in the behaviour of employees?

According to the Financial Services Authority, the Supervisory Board assesses whether employees are managed with suitable performance and competence agreements.[18] Furthermore, attention is paid to the skills that fit in with the changing enterprises, by selecting new employees that possess these skills and by training existing employees. The Supervisory Board therefore has HR knowledge.

Questions that the Supervisory Board could ask are:

- Is putting client interest central included as a competence in appraisal agreements (competence is implemented in specific behavioural criteria)?
- Are Board members role models, by regularly discussing the subject?
- Do employees have the freedom to devise their own initiatives in which the client interest is even more central?
- Are there KPIs that relate to careful client handling?

To summarise, supervising PARP means an important but also specialised task for the Supervisory Board. For that reason we recommend appointing a specific PARP Supervisory Board member and also to ensure that PARP issues will be discussed on an integrated basis. In our opinion, PARP belongs to the scope of attention of the Chairman of the Supervisory Board.

For example, a bank has three core Supervisory Board members with the following scope:

- Chairman of the Supervisory Board (mission, vision, market developments, strategy, new advisory and earning models, HR and shareholders).
- Chairman of Audit and Risk committee (finance, audit, risk management and Basel III/CRDIV).
- Member with compliance, governance financial and legal aspects, and internal organisation expertise.

The Board member taking the initiative for PARP could be the chairman because PARP is closely related to mission, vision, market developments and strategy.

Finally we recommend introducing a specific PARP Committee. In practice, it can be observed that PARP issues are discussed in the Audit Committee. However, the Audit Committee’s perspective is financial and risk management, rather than adding value for clients. In PARP terms, it is too much retrospective and too little prospective. Our recommendation is in line with the EBA Guideline on Internal Governance.

- EBA states: ‘The management body in its supervisory function should consider … setting up specialised committees consisting of members
of the management body (other persons may be invited to attend because their specific expertise or advice is relevant for a particular issue). Specialised committees may include an audit committee, a risk committee, a remuneration committee, a nomination or human resources committee and/or a governance or ethics or compliance committee. Of course delegating to such committees does not in any way release the management body in its supervisory function from collectively discharging its duties and responsibilities but can help support it in specific areas if it facilitates the development and implementation of good governance practices and decisions. A specialised committee should have an optimal mix of expertise, competencies and experience that, in combination, allows it to fully understand, objectively evaluate and bring fresh thinking to the relevant issues. It should have a sufficient number of independent members. Each committee should have a documented mandate (including its scope) from the management body in its supervisory function and established working procedures. Membership and chairmanship of a committee might be rotated occasionally.[19]

Proper risk management

In addition to the current set of risk management fields, ranging from credit risk to liquidity risk, we believe a new form a risk management will come into place. This new form will focus on the duty of care and the question whether a product actually has value for the customer and will actually fulfil customer’s needs. Let us call this new type of risk as suitability risk.

Conclusion

Value for clients is a new innovative and strong conduct of business concept, and thinking in terms of target group is very important when launching new products and services. However, banking intends not only to offer value to clients but also sound risk management, ensuring the bank will be solvent not only today but also tomorrow thus protecting the saver. Banking is about balanced integration of conduct of business and prudential norms. When introducing or implementing new PARP conduct of business regulations you will face dilemmas and conflicting views. At banker’s level a moral compass could therefore be helpful in implementing new rules. It is not in the first place about following the letter of the law and reliance on guidance. Instead, accountable banking is about internally embedding norms, integrity, the spirit of the law and professional individual responsibility. The question is not in the first place how to comply with external rules; instead, the primary consideration should be in my opinion as a banker, what is sound and value adding banking? After all, the banker is the entrepreneur, not the legislator or supervisor. For supervisors it means to be aware that PARP will be regulated not only prudentially but also from a completely different conduct of business perspective or approach.

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Endnotes

2. The Joint Committee of three European Supervisory Authorities (ESAs), is a forum established on 1 January 2011, with the goal of strengthening cooperation and ensuring cross-sectoral consistency between the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA), collectively known as the European Supervisory Authorities (ESAs).
3. The Banking Code (Code Banken) was drawn up by the Netherlands Bankers’ Association (NVB) in response to the report entitled ‘Restoring Trust’ (‘Naar herstel van vertrouwen’), which was published by the Advisory Committee on the Future of Banks (Adviescommissie Toekomst Banken) on 7 April 2009 (http://www.nvb.nl/en/media/document/000601_ code-banken-uk.pdf)
4. The Banking Code art 4.5.
5. The Act on Financial Supervision (Wet op het financieel toezicht [Wft]) has come into effect on 1 January 2007. The Wft brings together practically all the rules and conditions that apply to the financial markets and their supervision. In total, the Wft replaces eight existing supervision Acts. The extensive system of supervision of financial institutions that existed in the Netherlands (supervision of banks, insurers, collective investment schemes, etc.) is replaced by a single Act and subordinate regulations based on this Act. (file://C:/Users/Gebruiker/Downloads/act-on-financial-supervision.pdf).
6. The Decree on Conduct of Business Supervision of Financial Undertakings under the Wft (Besluit Gedragstoezicht financiële ondernemingen Bgfo) elaborates the provisions of Pt 4 of the Financial Supervision Act (Wet op het financieel toezicht/Wft), namely the part on the conduct of business supervision of financial undertakings. The rules in this decree are in principle set out per subject in the same order as in the part of the Act dealing with the conduct of business supervision of financial undertakings.
10. Bgfo art 32(1).
12. Bgfo art 32(1).
13. Based on art 32(2) a Bgfo.
14. art 32(2) c Bgfo.
17. In its Green Paper ‘Corporate governance in financial institutions and remuneration policies’ the European Commission concludes: ‘The financial crisis clearly shows that financial institutions’ boards of directors did not fulfil their key role as a principal decision-making body. Consequently, boards of directors were unable to exercise effective control over senior management and to challenge the measures and strategic guidelines that were submitted to them for approval. The Commission considers that their failure to identify, understand and ultimately control the risks to which their financial institutions were exposed is at the heart of the origins of the crisis.’: 6 (http://ec.europa.eu/internal_market/company/docs/modern/com2010_284_en.pdf).