

# Inside

COO  
CHRO | EDITION  
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Outsourcing, today and tomorrow

The power to tax is not the power to destroy!

Information management operational challenges in the fund industry

Intensive collaboration realising investment managers operational excellence

The Special Depository - Between opportunity and challenges

Demystifying change management

Talent Challenges in FSI - Designing responsive solutions through workforce analytics

Financial crime compliance - It's no longer sufficient to 'go it alone'

Reliable AML controls based on complete and accurate static data

LEI - The 4G of transparent market data

FATCA - The final stretch before going live?

VAT data management, with or without ERP - A key challenge for wise COO

The cloud revolution within HRIS

Digitisation of documents and legal archiving

The need for multilevel healthcare governance

Governance of large EU projects - Trends, challenges and solutions

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n Facts nutritive	
(5 mL) / par 102 tasse (125 mL)	
	% valeur quotidienne
Calories 130	
Protéines 1 g	1%
lipides saturés 0.1 g	1%
Glucides 0 g	
Cholestérol 0 mg	0%
Sodium 400 mg	18%
Glucides 23 g	8%
Fibres 6 g	25%
Acides gras 1 g	
Alcool 0 g	

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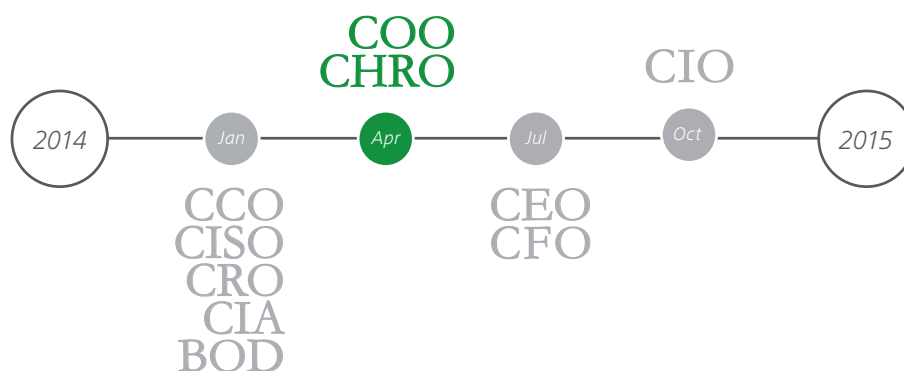


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# Foreword



Dear readers,

We are pleased to bring you the new issue of *Inside* magazine. The previous *Inside* issue, dedicated to CCOs/CISOs/CROs/CIAs/Board of Directors/Board Committees, has demonstrated how to anticipate and manage risk in an increasingly dynamic and uncertain environment. In line with the last edition's aim to think about ways to protect an entity, it is now time to take a closer look at the hectic daily life of an organisation.

This new edition is centred on topics related to the roles of Chief Operational Officers (COOs) and Chief Human Resources Officers (CHROs). You will find valuable contributions from a wide range of experts, coming both from the industry and Deloitte network. Our selection of articles focuses on the financial sector, without overlooking other industries such as healthcare and supranational organisations, for which we have built strong interest and expertise over time. Deloitte's experts have put their thoughts into words regarding key challenges.

We have also invited renowned professionals from the industry to share their views on the trends and innovations taking place in their markets. The combination of Deloitte's expertise and our clients' knowledge is at the heart of our philosophy. Once again, we would like to thank our various contributors, who are always willing to take the time to share their experiences and knowledge through the magazine.

Our magazine is growing quickly, not only in size but also in content. *Inside* is a way of connecting and sharing know-how and viewpoints concerning current and future trends impacting your professional life, working environment and industry. Your comments and suggestions for future topics or article contributions are always highly appreciated.

Enjoy this edition and we look forward to hearing from you.

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# Editorial

We would like to welcome you to the 4th edition of Deloitte's *Inside* Magazine.

This edition is particularly devoted to the Chief Operating Officers and Chief Human Resources Officers who are evolving in an ever more complex environment. The world emerging from the financial crisis is difficult to grasp. In this context, COOs/CHROs now face the growing pressure to reduce costs while enhancing the capabilities of their organisation, or at least maintaining them at the current level.

Indeed, in today's competitive, hyper-connected world, entities are required to operate at ever-increasing levels of efficiency. As a consequence, this issue is about operational excellence and efficient target operating models, which are the ultimate objectives of a COO/CHRO. The efficiency of operations and underlying processes are the core of an entity's daily operations. Outsourcing is, in this perspective, a hot topic in many industries. Such a quest for performance is of course closely linked to technological opportunities (e.g. cloud, digitisation, legal archiving, information management, etc.).

This is the time when challenges are becoming arduous, time-consuming and therefore substantially expensive due to new regulatory constraints (e.g. anti-money laundering, counter terrorism financing, anti-corruption, FATCA, etc.). Our experts show that it is possible to turn these constraints into advantages, as explained through the tax relief and reclaim assistance. This issue of *Inside* asserts that it is possible to use constraints as a springboard to engage in a positive transformation. To conclude, as stagnation is likely to lead to inefficiency, organisations will most probably seek for change, especially in such a fast-paced environment.

We hope you enjoy reading this edition.

Thank you for your interest and support.



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# Outsourcing, today and tomorrow

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### Outsourcing: a continual work in progress

As the financial markets continue to evolve, financial institutions are working to grow and maintain profits while adjusting to ever-changing regulations and the effects of the downturn on profitability and performance. Successful institutions will need to reassess their operating models and address the effects of regulatory reform, competitive dynamics, evolving markets and increased expectations from stakeholders. The main challenges currently faced by banking institutions can be categorised as follows:

#### Banking industry strategic challenges

Although not spared by the European crisis, the Luxembourg financial centre still remains a major player in the international environment.

Banks in Luxembourg have to face significant strategic challenges. Private banking industry professionals need to reinvent themselves in order to cement Luxembourg's position as a leading centre for private banking services. Retail bankers also have to face growing competition from abroad as well as from non-traditional institutions.

Asset management and investor services institutions need to prepare themselves for significant changes in infrastructure, regulatory frameworks and their competitive landscape.

Institutions will have to improve their understanding of their clients and re-examine the value and marketing of their products to ensure they remain competitive in this new environment.

#### Banking industry regulatory challenges

The constant evolution of local and international regulations is a major driving force in the banking and securities industry.

The introduction of the OECD's Multilateral Convention on Mutual Administrative Assistance in Tax Matters by Luxembourg in May 2013 and the subsequent announcement that the automatic exchange of information will be implemented by 1 January 2015, for example, will have a major impact on the way institutions run their business. A sustainable business model must be based on transparency. The introduction of new oversight rules and bodies may also have far-reaching implications for the industry.

Implementing all these rules can be an issue, yet the real challenge is more about optimising your regulatory investments than merely complying.

#### Banking industry operational efficiency challenges

To address strategic and regulatory challenges appropriately, immaculate execution is a must. Constantly improving operational efficiency has to be high on the agenda of bankers. Now more than ever, institutions have to optimise their processes, control their cost structure, and explore new operating models using all the tools currently at their disposal.

Analysing the opportunity to mutualise operations or IT systems across entities or regions, outsourcing non-core activities and improving risk management frameworks and tools are some of the areas where financial institutions can find the levers to reach excellence.

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## Banks in Luxembourg have to face significant strategic challenges



### Leveraging the value of outsourcing

#### Overcoming compliance challenges

Demands on compliance functions are rapidly increasing and so are the risks associated with failing to meet these demands. An organisation's non-compliance with regulatory requirements can result in legal sanctions, consent decrees, prosecution, liability suits, failed business strategies and damage to reputation and brand. In extreme cases, non-compliance can threaten the very existence of the organisation.

Compliance is not a revenue-generating business function. However, it is a core component of managing enterprise risk and successfully executing business strategies. Hence, due to the extent of compliance demands, many organisations maintain large and growing compliance functions that increase their overall operational costs.

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Each organisation must develop and consider its individual business case for outsourcing compliance versus supporting compliance with an in-house operation, which may require ever-increasing investment in talent and IT resources

The increasing volume and complexity of regulations, an ongoing talent shortage and constant pressure from shareholders to reduce operating costs make this a good time to consider alternative sourcing strategies.

Compliance outsourcing can help organisations to address compliance demands while staying focused on their core business functions and go-to-market strategies.

#### What is compliance outsourcing?

Compliance outsourcing is the outsourcing of business functions and processes associated with compliance to a party other than an in-house compliance department —usually to a third-party provider or vendor located domestically or offshore. Compliance processes may be outsourced to a captive organisation, such as a subsidiary owned by an organisation or its parent company, or to a third-party provider. On the scale between a wholly-owned captive and a third-party provider there are several variations.

Organisations unfamiliar with compliance outsourcing might view the practice as impractical or even impossible. Challenges in areas such as data privacy, regulatory complexity, reporting accuracy, responsiveness and infrastructure might initially appear to rule out compliance as a candidate for outsourcing. Yet, some of those challenges actually argue in favour of compliance outsourcing, as they may in fact be addressed more effectively by specialists outside of the organisation. Having challenges addressed effectively and economically is a major benefit of compliance outsourcing.

A strategy of selective outsourcing – choosing which compliance processes to conduct in-house and which to outsource – can enable the organisation to improve the allocation of its resources. This reflects the overall goal of outsourcing: to place operational functions with a third party who can execute them at high levels of quality, with responsiveness, cost-effective delivery model and to free up internal resources for revenue-generating activities.



### Types of outsourcing

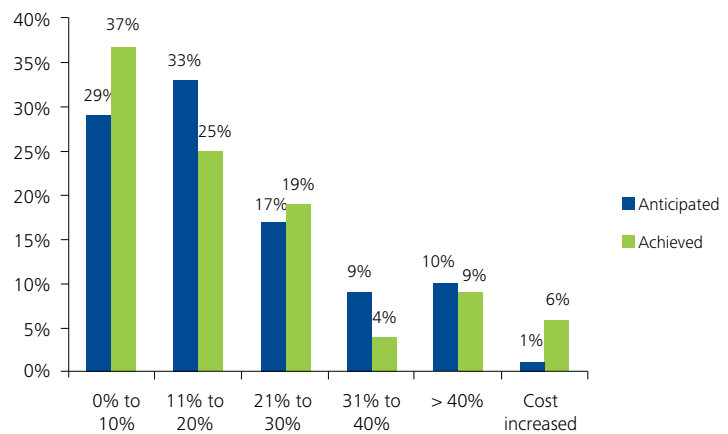
Compliance outsourcing is a type of Knowledge Process Outsourcing (KPO), which in the past few years has joined its long-established counterparts – Information Technology Outsourcing (ITO) and Business Process Outsourcing (BPO) – as an accepted practice. KPO activities tend to be more complex than those associated with ITO and BPO. KPO calls for the application of knowledge, such as industry knowledge, understanding of regulations, compliance frameworks, valuation, actuarial experience and data analytics to generate knowledge-intensive deliverables.

Over time, the organisation can foster strategic relationships with the right outsourcing providers, relationships that add strategic value—that is, value beyond simple provision of services. For example, providers of outsourced services can encourage innovation and increase competitiveness. They can do so not only by providing leading practices in their areas of specialisation, but also by enabling management to focus on the true strategic agenda of the company.

Management can do this because outsourcing frees up executives’ attention and ‘intellectual bandwidth’, as well as financial, human, IT and other resources. This can also enable leaders to pursue the strategic agenda more vigorously and with fewer distractions.

In addition, outsourcing provides well-documented cost benefits. Deloitte research has revealed that 57% of companies having outsourced business functions achieved cost savings of more than 10%.

Figure 1: anticipated and achieved cost reductions from outsourcing



Source: Deloitte research

### What are the driving forces for compliance outsourcing?

The decision to outsource may be driven by one or more of the specific challenges currently faced by compliance functions, including the following:

- **Coping with talent shortages:** increased regulatory compliance complexity requires individuals who are skilled in risk management and have knowledge of regulatory and compliance operations. These professionals are in short supply and high demand. Organisations have to deal with increased operational budgets to provide training, an extended talent pool to manage continued compliance and high attrition issues.
- **Sub-optimal compliance processes:** organisations want to focus on improving and streamlining to make their compliance processes predictable. However, constant changes to the regulatory landscape can make investments in compliance processes reactive. This often leads to a challenge for the organisation whereby compliance processes may not follow the leading practices. This can result in a higher cost of compliance, lower quality levels and possibilities of rework.
- **Investing in technology infrastructure:** organisations are continually investing in technology and related infrastructure to help facilitate meeting compliance needs. With the constant changes to existing regulations, as well as new regulations, technology investment needs are both one-time and recurring.

- **Addressing global compliance needs:** international organisations are investing extensively in hiring and training a global talent pool. Additional investment is needed to develop a global knowledge base and expertise to address differences in regulatory requirements and successfully drive their global compliance operations.
- **Increasing operating costs:** increased resource requirements (people, processes and technology) due to significant changes in regulatory environments are having a major impact on operating costs.

### What is the business case for compliance outsourcing?

Each organisation must develop and consider its individual business case for outsourcing compliance versus supporting compliance with an in-house operation, which may require ever-increasing investment in talent and IT resources. Demand for compliance systems and talent has raised the cost of maintaining compliance infrastructure. Even with proper funding, an organisation's ability to scale up compliance operations may be limited by the availability of adequately qualified people to an in-house compliance function.

Outsourced compliance providers can offer several potential advantages over in-house compliance functions, mainly owing to the specialisation and systems they must maintain as service providers.

Considerations	In-house	Outsourced
Cost	Fixed	Variable/reduced
Staffing flexibility	Limited	Just-in-time
Competency/skills	Constrained	On-demand
Talent availability with industry knowledge	Limited	Readily available
Training impact	Time and cost	None
International challenges (language, local laws, travel time and costs)	Significant	Minimal
Leading practices	Siloed	Holistic
Speed of change	Slower	Proactive

In contrast, external providers focus on developing and maintaining the required knowledge as a core competency, often by hiring former regulators and compliance officers and developing industry-aligned talent pools. The external providers also bring their process frameworks, knowledge from performing similar services for other clients and accelerators to the delivery of value-based compliance outsourcing services.

In providing compliance as a service, compliance outsourcing providers develop and maintain the necessary talent, knowledge base, industry knowledge, process frameworks, scalable infrastructure and global presence. They devote resources to monitoring and understanding regulatory demands, and amortise the costs of compliance across their client base. As a result, compliance needs can be addressed cost-effectively and liberate resources moved to higher value activities. In a nutshell, this is how efficient compliance outsourcing works.

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## Constantly improving operational efficiency has to be high on the agenda of bankers



# The power to tax is not the power to destroy!

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Over the last few years, the Luxembourg private banking industry has faced a series of challenges that require a structural reshaping of its business model. Luxembourg private bankers will definitively have to differentiate and innovate in order to maintain their attractiveness vis-à-vis clients who are increasingly on the look-out for advice to optimise their investments.

In this context, an efficient tax management of their clients' investments is a true value-added service that private bankers need to consider. Let's step back for a minute to understand the recent changes that have impacted the Luxembourg environment before describing one of these new value proposition services: Tax Relief & Reclaim assistance.

#### Moving toward a fiscally transparent environment

Since 2009, several initiatives at both European and international level have impacted and are going to further affect the scope of banking secrecy so that Luxembourg can gradually enter a fiscally transparent environment bursting with challenges and opportunities:

<sup>1</sup> 2003/48/EC

<sup>2</sup> The automatic exchange of information under the EUSD is broadly applicable to interest paid to individuals resident in an EU Member State other than the one where interest is paid.

<sup>3</sup> 2011/16/EU

<sup>4</sup> Article 26(5) of the OECD Model Tax Convention (exchange of information provision)

<sup>5</sup> [http://www.impotsdirects.public.lu/conventions/conv\\_vig/index.html](http://www.impotsdirects.public.lu/conventions/conv_vig/index.html)



- In the 2013 State of the Nation speech, the former Prime Minister Jean-Claude Juncker announced that Luxembourg will apply the automatic exchange of information as provided by the EU Savings Directive<sup>1</sup> with effect from 1 January 2015 (hereafter the 'EUSD'). Luxembourg banks will therefore have to transmit the information foreseen in the EUSD to the Luxembourg tax authorities, which will then confidentially transmit the information to the corresponding revenue service in the EU Member State in which the beneficial owner is a resident<sup>2</sup>. The new Finance Minister Pierre Gramegna confirmed Luxembourg's commitment to move forward towards automatic exchange of information at the ECOFIN meeting on 10 December 2013.
- In May 2013, the former Finance Minister Luc Frieden announced that Luxembourg will sign a Model 1 Intergovernmental Agreement (hereafter the 'Model 1 IGA') providing for the automatic exchange of information between the Luxembourg and US tax authorities on bank accounts held in Luxembourg by citizens and residents of the United States. Even if the IGA between Luxembourg and the US has not yet been executed, it is foreseen that Luxembourg banks will report tax information to the Luxembourg tax authorities, which will then automatically transmit the information to the US tax authorities.
- In 2013, Luxembourg also adopted a law effective from 1 January 2013 that implements the EU Directive on administrative cooperation in the field of taxation<sup>3</sup> as regards the exchange of information upon request and the spontaneous exchange of information. At the end of last year, a bill was submitted to the Luxembourg Parliament to implement the remaining part of this EU Directive in connection with the automatic exchange of information limited to the following categories of income: salaries, directors' fees and pensions and annuities.
- Last but not least, following the G20 Meeting held in London in April 2009, Luxembourg has amended existing tax treaties and signed new tax treaties where, except in the case of fishing expeditions, a request for information cannot be denied solely because it is held by a bank or another financial institution<sup>4</sup>. As of today, 37 tax treaties signed by Luxembourg are compliant with the exchange of information provision enacted in the OECD Model Tax Convention<sup>5</sup>.

In this new environment, the Luxembourg Private Banking centre will not only be in direct competition with other international financial markets like Switzerland, but also with rapidly developing homeland private banking players, which provide services to resident clients and retain the share of the richest individuals. There is a definitive need for private bankers to develop innovative value proposition services.

### Tax Relief & Reclaim assistance: how can tax create value for clients?

#### Introduction to double taxation issues

Each time a cross-border investment is made, there is a risk that the income derived from such investment may be taxed twice. One of the most common double taxation issues is 'juridical double taxation' where the same income is taxed twice in the hands of the same taxpayer. For example, it is fairly common for a dividend payment to be taxed in the country of source<sup>6</sup> by way of withholding tax in a first instance and then to be subject to income taxation in the investor's country of residence<sup>7</sup> by way of a tax assessment.

#### Tax Reclaim

A dividend paid by a German corporation to a Luxembourg resident investor is in principle subject to an upfront 26.375% withholding tax rate.

The Luxembourg investor can claim the benefit of the reduced dividend withholding tax rate (15%) based on the Germany–Luxembourg tax treaty, leading to a tax refund of 11.375% of the gross dividend amount.

The remaining 15% can be credited against their Luxembourg income tax.

#### Relief at Source

A dividend paid by a French resident company to a Luxembourg resident investor is, in principle, subject to an upfront 30% withholding tax rate.

A Luxembourg resident investor is in principle eligible for relief at source from withholding tax on dividends based on the France–Luxembourg tax treaty, leading to a reduced final withholding tax of 15%.

The net dividend received by the Luxembourg resident investor at the time of the dividend payment will therefore amount to the gross dividend amount less the final withholding tax of 15%.

As double taxation may discourage cross-border investments and affect their financial return, countries have started to enter into bilateral tax agreements whose main purpose is to eliminate or reduce double taxation.

Hence, most countries agree to levy withholding tax rates on outbound dividend and interest payments that are lower than the default rate applicable according to domestic tax legislation. Investors are then entitled to a tax credit for the remaining withholding tax leakage. In other words, the final withholding tax charge incurred in the country of source of the income can be deducted from the income tax due in their country of residence.

The benefit of the tax treaty rate can be granted either upfront at the time of the payment (**Tax Relief** or **Relief at Source**) or afterwards by way of a reclaim filed to the local tax authorities (Tax Reclaim). While the investor immediately receives an amount of dividend or interest after deduction of the relevant reduced withholding tax rate under a tax relief method, they initially incur the full domestic withholding tax rate under the tax reclaim method and receive the tax refund after the reclaim is filled.

Refund methods vary from one country to another. For example, relief at source is available for French source dividends while Germany only offers the possibility to reclaim dividend withholding tax (no relief at source).

#### An operational and organisational challenge

The implementation of a Tax Relief/Reclaim Service must be carefully prepared as it poses many operational and organisational challenges. We have highlighted some of these challenges below.

#### Withholding Tax Matrix

Before offering a Tax Relief Service to their clients, private banking players will have to prepare a Withholding Tax Matrix (hereafter the 'Matrix'), which must contain all information required to apply for either the Relief at Source or a Tax Reclaim.

This should include the following information for each country of investment:

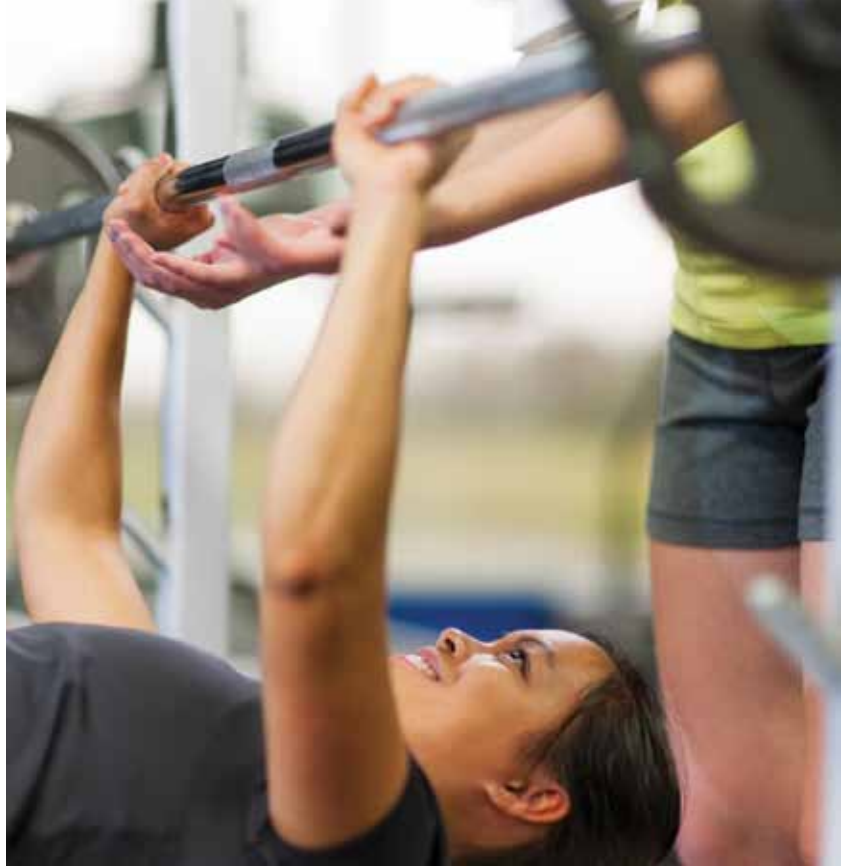
- Domestic withholding tax rates per type of security foreseen
- Tax treaty rates applicable depending on the investor's country of residence
- Possibility to get tax relief at source
- Claiming period
- Copy of the tax reclaim forms
- List of all supporting documentation required for the relief at source and tax reclaim

The main challenge here will be to keep this Matrix up-to-date and capture any changes in both domestic legislation and tax treaty networks that may affect the investors' right of refund. Access to a large network of local tax experts is crucial to remaining abreast of any relevant developments.

#### Client segmentation

Another key element is determining which commercial approach to pursue: either offering this assistance to top-tier clients or expanding the service to a wider client base. This decision will of course affect the volumes to be processed and impact the (internal and/or external) resources to be assigned to the project.

On the basis of client data extracted from the bank's systems, a Cost/Benefit analysis needs to be undertaken to determine the viable claims per client, i.e. the claims where the cost of pursuit is lower than the estimated tax refund. The automation of this Cost/Benefit analysis is crucial to enabling the bank to rapidly identify relief/reclaim opportunities, to start gathering all information and documentation required by local paying agents for the Tax Relief Service and to prepare the Tax Reclaim for filing with the local tax authorities. Such automation is even more important when the service is offered to a large number of clients.



#### Highly secured transfer of client data and information

A Tax Relief/Reclaim Service requires client data and information to be handled by and shared with external stakeholders, such as local paying agents and external tax service providers. It is therefore critical to set up a highly secured technology-backed solution that allows the Bank to remain in full control of its client data at any given time.

For example, the use of encryption software<sup>8</sup> will be necessary to protect such data. The connection between the bank and the external stakeholders will also need to be secured to ensure a high level of security. Depending on the volumes to be processed, a secured data sharing platform would be essential to provide easy and centralised access to client data and information in a secured environment.

Although the private banking industry is facing challenging times, there are plenty of opportunities to successfully navigate troubled waters. Tax Relief/Reclaim assistance requires a good understanding of the operational and organisational impacts, combined with excellent management of tax information. However, it provides clients with a distinctive value-added service where they can benefit from tax refunds, thereby improving the return of their investment portfolio.

Who said the power to tax is the power to destroy<sup>9</sup>?

<sup>6</sup> Country of Source can be defined as the country of the security's issuer. For example, Germany will be the Country of Source for dividends paid by a German resident corporation and for interest paid on German government bonds.

<sup>7</sup> Country of Residence can be defined as the country in which a person lives i.e. the country in which they have a place to live and where they normally spend daily rest periods. The tax treaty provides for some specific criteria to determine the residence of an individual.

<sup>8</sup> e.g. Pretty Good Privacy (PGP)

<sup>9</sup> Chief Justice John Marshall in 1819 US Supreme Court Ruling., *McCulloch v. Maryland*.

# Operational challenges of information management in the fund industry

Maxime Aerts  
Chief Operating Officer  
FundSquare

An investment fund is, by nature, a financial product. As a product, it has to comply with regulations and is meant to be sold to customers. The description of its characteristics is therefore subject to legal and commercial obligations.





Information on the product has to be compiled and made available for communication and usage. How this content is handled is therefore critical to ensure that the correct information is distributed. Regulators are strengthening the legal framework on investment funds in order to increase transparency and thus improve investors' protection. The aim of UCITS, MiFid, AIFMD and PRIPS, to name but a few, is to not only better inform investors on the products but also to better inform professional players on the investors and their ability to invest in the products.

Providing information is key for two reasons: to comply with regulations and—as funds are commercial products—to gain visibility. Managing information has thus become a challenge for both fund management companies and the distributors having to place transactions on behalf of their customers.

Fund houses create, manage and close instruments on a daily basis. Managing and transmitting information is required for three different reasons:

- Regulatory filing to register and distribute funds on selected markets
- Commercial information to update distribution networks and investors on changes in the portfolio of products
- Marketing, to attract new customers

The operational challenges are numerous and start even before the communication as such.

The type of information to be managed is the first challenge, as no commonly used standards exist for the definition and scope of data which identify a fund. Some initiatives have been launched by the industry in an attempt to define and rationalise a range of relevant static data, like the Fund Processing Passport or FundXML. The former has never taken off and the latter is not used enough to have become market practice. This situation is due to the difficulty of automating the compilation and update of information on the one hand and ensuring that all data is available on the other hand.

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## Format of information is the costly challenge: some recipients demand specific formats to automate the integration process on their end

Some areas present a particular challenge, for example 'identifiers' such as fund codes (ISIN but also others: CSSF code, Qsip, WKN, etc.) or entity codes (e.g. LEI), which may not even exist.

Updating information is a second big challenge. Time to market is important as it affects the distribution of a new or updated product. Good coordination is required between the different parties involved in the process, such as lawyers, auditors, the promoter, the central administrator and of course the regulator, which grants authorisation. The objective is to ensure that data and documents are available as soon as possible.

Format of information is the costly challenge: some recipients demand specific formats to automate the integration process on their end. This is the case for distribution platforms, main distributors and data vendors. From a fund house perspective, this means having the technology or skills to be able to generate and send specific file formats, which can be very different from one to the other, either technically (xml, csv, etc.) or in terms of content (scope and layout of the information).

Beyond the content and format, a recipient list is tricky to manage as, for some products, specific versions of documents have to be sent (e.g. KIIDs in the local language of the countries where a fund is distributed) or, alternatively, not sent (e.g. AIF documents are sent to specific investors only). Access to information must remain under control, when sent or even just made available on a website, which means controlling access to a website in the case of the latter.

The integrity of disseminated information raises the issue of its usage. How it is used is based on the recipient's processes, which are out of the control of the fund houses. There is no guarantee that information sent will be correctly displayed and in a timely manner. Reuse of information, especially by data vendors, can be an issue as it means the sending of information is completely out of fund houses' control.

At the same time, distributors face similar kinds of challenges: documentation and information on the range of products they propose to their customers must be available and up-to-date. Having access to fund documents is often easy as fund houses usually publish these documents on their websites. However, collecting information directly from fund houses is often complex and costly, especially getting the latest updates, as fund houses are not always proactive in providing information. Having distribution agreements in place is often a better way to ensure that updated information will be received from fund houses.

Having direct access or receiving information is the starting point, but it is not always possible; using data vendors to get a feed for a full or partial portfolio is often considered a practical way of enriching one's database.

In all cases, the difficulty stems from the coverage of information, the technical format, the need to consolidate and to perform quality checks. These activities are required to:

- Provide information to the end customers to fulfill both the legal obligations to inform customers and the moral obligation to properly advise—the latter being too often overlooked as distributors recommend the products that bring in greater profits for them (through retrocession agreements with funds), new regulations on consumer protection are aimed at enhancing transparency or forbidding these practices.
- Ensure all relevant information is present to create a transaction likely to be accepted by the transfer agent of the fund, especially regarding the type of investors, countries of distribution, cut-off times, accepted currencies and investment restrictions.

Information management is a legal and commercial must on both sides of the chain that is handled through complex and costly processes due to the numerous counterparties involved and variety of formats, which can be illustrated by a simplified picture of the spaghetti model shown below:



This situation, as is often the case in the fund industry, results in opportunistic actors popping up to offer commercial services relating to data collection or management or dissemination or indeed all of the above, with the objective of making money out of these inefficiencies.

The multitude of service providers in the area is generating much more complexity as the range of services, the scope of information and the formats collected or disseminated are of course not the same. Customers buying these services have no other choice than to combine the services of several providers and interact directly with certain counterparties, which leads to further complexity and of course, costs. At the end of the day, these costs are always borne by the investors, either directly or indirectly through impacts on the performance of the funds and therefore lower return on investment.


Regulators have not yet focused on the area of information management to impose a limit on costs or even fix costs, like for example on cross-border settlements (T2S). The situation is not new and some initiatives aimed at standardisation have already been launched. The main problem with all past initiatives was usually the absence of any obligation that they be implemented, which prompted many to 'wait and see' and meant that they never gained the critical mass to become a market standard accepted and used by the industry. Hopefully this situation will change. Some markets have taken note of the situation and are trying to launch initiatives. For example in France, the industry is analysing the feasibility of putting in place a mandatory 'market referential' with fixed scope and format. This is a good step towards rationalisation and limiting costs in the industry, something which should be encouraged.

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Providing information is key for two reasons: to comply with regulations and—as funds are commercial products—to gain visibility







# Intensive collaboration realising investment managers operational excellence

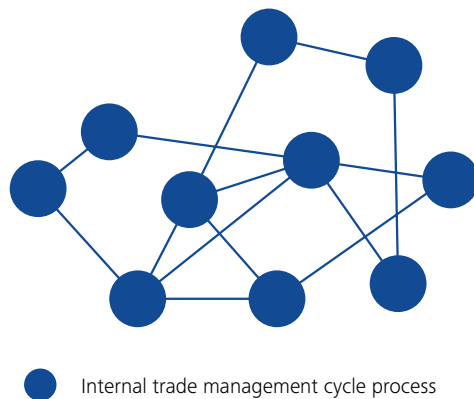
Jordy Miggelbrink  
Deloitte Alumni

The May 2013 edition of *'Performance'* published by Deloitte described the characteristics of investment management organisations that will be able to competently respond to the massive shifts in the economic, regulatory and investment landscapes and therefore will be best equipped to survive the next decade. Our perspective requires that investment managers optimise their focus on investment strategies and philosophies. This can be effectively achieved by a process of continuous improvement in organisations' operational (trade) processing environment.

We concluded that the optimal change strategy for trade cycle management should be focused on long-term mutual collaboration with partners who can offer specialised or enhanced levels of support to the business operation. This approach will ensure the business is best positioned to resolve the complexity of the challenges that will continue to be presented by the ever-changing investment landscape.

### Demands for increased transparency

Forthcoming regulations, for example EMIR, require trade reporting within pre-defined timeframes from the moment trading takes place. Regulations within the insurance sector (Solvency II) also have an indirect impact on investment management parties. These enhanced regulations require investment management organisations to adjust their operational procedures to deliver increased transparency, demonstrable risk-based modelling, and improved 'look-through' reporting functionalities. Beyond the need for increased transparency driven by regulatory requirements, investment managers must also deal with investors' changing demands. Requests for information, sometimes within short time frames, take a toll on the operational processing of investment management organisations. Failure to obtain accurate and complete information within timelines required by investors can put the investment manager at risk. Increasingly, potential investors' due diligence processes will probe into a firm's operational trade processing procedures.



### The current operational 'starting point'

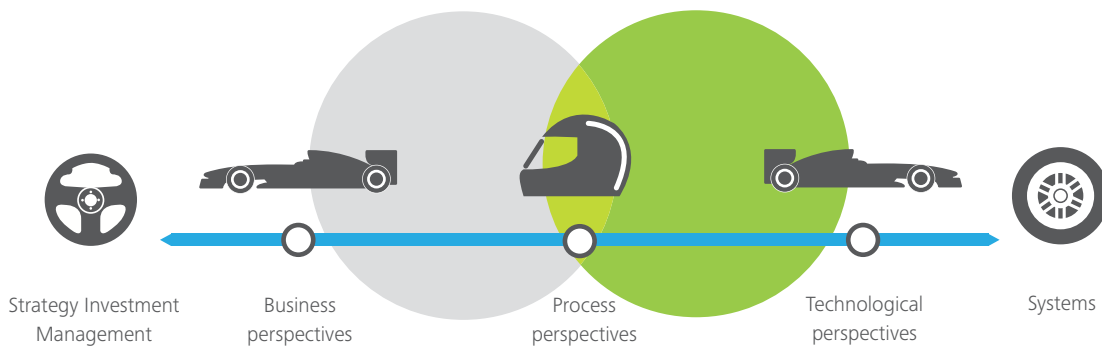
Off-the-shelf Trade Cycle Management solutions are increasingly being selected to standardise both system and operational processes with the objective of improving investment managers' margins. These solutions deliver an increased rate of straight-through processing and provide greater transparency.

The software solutions implemented, however, generally only support a (small) part of the operational process. Consequently, new functionalities are often delivered without consideration of further up-stream or down-stream processing or are inefficiently built on top of or alongside existing legacy systems. The implementation of multiple standardised off-the-shelf solutions to try to effectively support the complete trade management cycle results in extra software licence fees and related operational costs.

Besides the increased implementation complexity and extra operational costs of this approach, many well-known software vendors increasingly seem to have difficulties in foreseeing and adapting to the challenges of complete operational processing in their off-the-shelf solutions. Vendors can be reluctant to change or adapt their 'standard' product offerings and thus the investment management organisation must find their own specific solution(s). This may result in redundant implementation of support tools, a need for increased internal system-to-system reconciliation and accordingly increased operational risks.

### Implementation example

It is not uncommon for an investment management organisation to have implemented one specific solution for the functions of 'order management', 'compliance' and 'trading' and a second and third etc. for functionalities like 'accounting', 'data management' and 'settlement'. This situation leads to multiple-translations between systems in the different parts of the organisation likely to cause operational incidents. For example, the investment manager might have the transaction code



'BU', 'BO12', 'Opening', 'BUY' or a numeric code for reflecting the execution of a trade, depending on the department and solution implemented.

While these incidents are being reactively resolved, the organisation is consequently exposed to uncertainty in its trading position, affecting the truthful prediction of settlements and the verification of securities and cash held with custodians.

Additionally, from a technological perspective, having to support multiple legacy software systems presents a significant challenge. Legacy technologies, often developed in the early 1990s, are increasingly unable to meet current requirements for real-time information and web-based reporting.

**The strategy should be 'simple'**

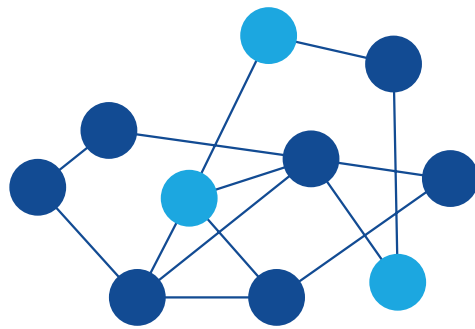
The experiences described earlier demonstrate that investment management operational processes must work faster and smarter with the objective of minimising errors and omissions. The numerous challenges presented by this strategic goal should be met by forming a close long-term collaboration with a specialist and knowledgeable partner. The objective, to proactively prevent data quality and processing errors from occurring in the trading environment, will reduce the need for unwanted additional reconciliation, internal reporting and monitoring.

The strategic approach is preferable both from a technological and a business perspective. To optimise all aspects of the trade management cycle into one solution, the investment strategy and investment philosophy of the organisation must form the core of the architecture. The solution must be built around the business (rather than adapting the business processes to work with a fixed solution).

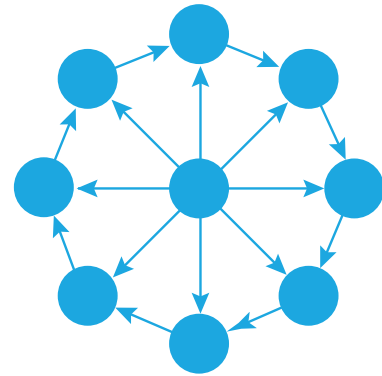
The investment management operational environment should be perceived 'as one' cycle, reusing the same events from different perspectives. Without this approach it is impossible to define one complete roadmap: unnecessary resource-consuming challenges will be presented when front- to back-office functionalities are not considered in relation to each other. The total trade management cycle must be defined from start to finish with all data being validated at the point of first entry. Functional exceptions are managed as one encapsulated event instead of being repeated and corrected at each translation interface between each sub-system and component.

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**In order to gain greater levels of efficiency, investment managers increasingly share their support functions and/or outsource highly-commoditised operational functions to specialised outsourcing partners**



- Internal trade management cycle process
- External trade management cycle process



- Optimised trade management cycle process

**Complementary collaboration: more than the sum of its parts**

**Outsourcing to a partner**

In order to gain greater levels of efficiency, investment managers increasingly share their support functions and/or outsource highly-commoditised operational functions to specialised outsourcing partners. These secondary operational processes will generally not differentiate the investment manager from competitors so consequentially costs associated with technology, staff and real estate could potentially be reduced.

One of the lessons learned during various client missions is that operational and financial risks are not reduced if the trade management cycle processes have not been optimised before the outsourcing partner begins executing this day-to-day business. Effectively nothing will change except the location of the proceedings.

In addition, regulations outline that the investment managers' organisation remains responsible for outsourced functions, so outsourcing the risk of processing errors is not an option. This may in fact adversely impact the accuracy, completeness and timelines of reporting financial transactions and statements. When differences appear the investment manager must be in control of the identification, investigation and explanation of errors and all corrective actions. Consequently extra reconciliation processing must be implemented to ensure that the outsourcing party is in control of the execution of the operational processing.

**Innovative specialised (software) partner**

Defining the trade management cycle as one organisation-wide operational process enables investment managers to identify the consequential events required at the various points in the front-, mid- and back-office environments. In the earlier example, 'execution of a trade', the investment manager can identify the data discrepancy when the data is first entered into the trade cycle. Consequently a potential breach is identified at the earliest possible opportunity, preventing problems from manifesting themselves further down the line in the operational process and improving the quality of accurate prediction of settlements. Such a strategy will have a direct positive impact, reducing the operational risks of the investment manager and ensuring that operational processing costs are controlled.

Current off-the-shelf standardised legacy solutions are not ready to meet the enormous challenges of the new post 'credit crunch' investment management environment. Furthermore, given the ever-increasing complexity of financial markets, investment management organisations must be fully focused on their key objectives and not distracted by inefficient operational processing. Intensive mutual collaboration with a software partner specialised in investment management will strengthen the investment managers' mission and organisation. A software partner with expert knowledge and flexibility, able to assess the investment manager's needs, based on the newest technological and functional perspectives, will give the investment manager the best chance to succeed in today's complex asset management industry.





### Conclusion

Based on our extensive market experience within the investment management industry we recognise the struggles investment managers encounter in their day-to-day business. We believe that the overriding key to success is to allow the manager to focus on investment strategies by enhancing their trade management cycle, working smarter and with the lowest possible number of data related incidents.

To meet these challenges it is essential to form an intensive mutual collaboration with a specialised party who is committed for the long term. Achieving an operational investment management process, which is based on accurate, timely and fully accessible financial positions, facilitates the right investment decisions and generates absolute returns benefiting the investment managers' clients in the long term.

The option of outsourcing could lead to advanced levels of efficiency and decreased trade management cycle budgets. However, if the trade management cycle has not been optimised the question remains: is outsourcing enough to survive the ever changing market circumstances and will future changes be adequately implemented by the outsourced partner? The investment management organisation remains responsible for the functions outsourced and liable for the resulting risks. Given the constant changes in the investment industry and continuous technological developments in operational information management, we believe that the investment management sector will see a shift towards intensive long-term mutual collaboration with innovative software providers. This tactical approach enables the optimal implementation of solutions which are technologically and functionally at the top of the range.

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The experiences described earlier demonstrate that investment management operational processes must work faster and smarter with the objective of minimising errors and omissions

# The Special Depository Between opportunities and challenges

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The AIFMD (Alternative Investment Fund Managers Directive) is an important piece of regulation that brings the world of alternative investments under a single roof.

One of the centrepieces of AIFM is an extensive set of requirements for depositaries of assets, covering their duties and liability. They considerably reinforce the conditions for the delegating of safekeeping duties over an Alternative Investment Fund's (AIF) assets, the selection and monitoring of these service providers and the supervision of assets with full liability for the depository in the event that financial instruments held in custody are lost.

Acting as a depository for an AIF means facing considerable changes and challenges but is also an excellent opportunity for new business models to emerge in a world that is becoming more complex and more demanding. Our aim is to highlight some of the challenges and opportunities in this article.

## A wide universe of assets

The universe of investments that can be made by AIFs is driven by the appetite of investors to invest in different and very diverse types of assets. Many of these assets are actually not financial instruments at all.

Understanding the nature of asset classes is an important starting point when it comes to looking into the opportunities and challenges for special depositaries. Furthermore, the general duties of the depository differ depending on whether an AIF holds financial or non-financial assets and the lines between both asset classes are not as clear-cut as they seem. Depositaries and asset servicers are therefore well advised to fine-tune their understanding of these definitions, and to draw clear lines:





## Duties of the Depository

### For financial assets:

- Ensure proper registration of assets
- Maintain accurate records and segregated accounts, in particular recording correspondence with financial instruments and cash held for AIFs
- Conduct regular reconciliations between the depository's internal accounts and records, including those of third party delegates
- Ensure due care and high standard of investor protection for financial assets held in custody
- Assess and monitor relevant custody risks throughout the custody chain and keep AIFM informed of identified material risk
- Introduce adequate organisational arrangements to minimise the risk of loss or diminution of assets, or rights in connection with the assets caused by fraud, poor administration, inadequate registering or negligence
- Verify AIF's ownership right or ownership right of the AIFM acting on behalf of the AIF over the assets

**'Full'  
safekeeping**

### For non-financial assets:

- Not safe kept by the depository but partial safekeeping delegated to a relevant third party entity
- Ownership verification of the AIF's assets
- Record keeping duties for the AIF's assets
- Reconciliation of AIFM instructions

**Ownership  
verification &  
recordkeeping**

### Definitions:

A **financial** asset is a title of ownership instanced by the notion of a transferable security. It follows that this title of ownership in either material or de-materialised form may be held in safe keeping.

- The market is currently seeking to clarify these definitions
- As the definitions are not yet fully clear, implementing guidelines will also be necessary

A **non-financial** asset is a contract or a right of ownership evidenced by a contractual transfer of ownership or a right of entitlement to property that is not materialised by a transferable security. As such, the existence of this contract or title is the operable concept rather than any notion of validity as to where that contract is physically held.

### Welcome to complexity

Non-financial assets are by nature very diverse and have their very own particularities. In fact, there are virtually no limitations to the scope of non-financial assets.

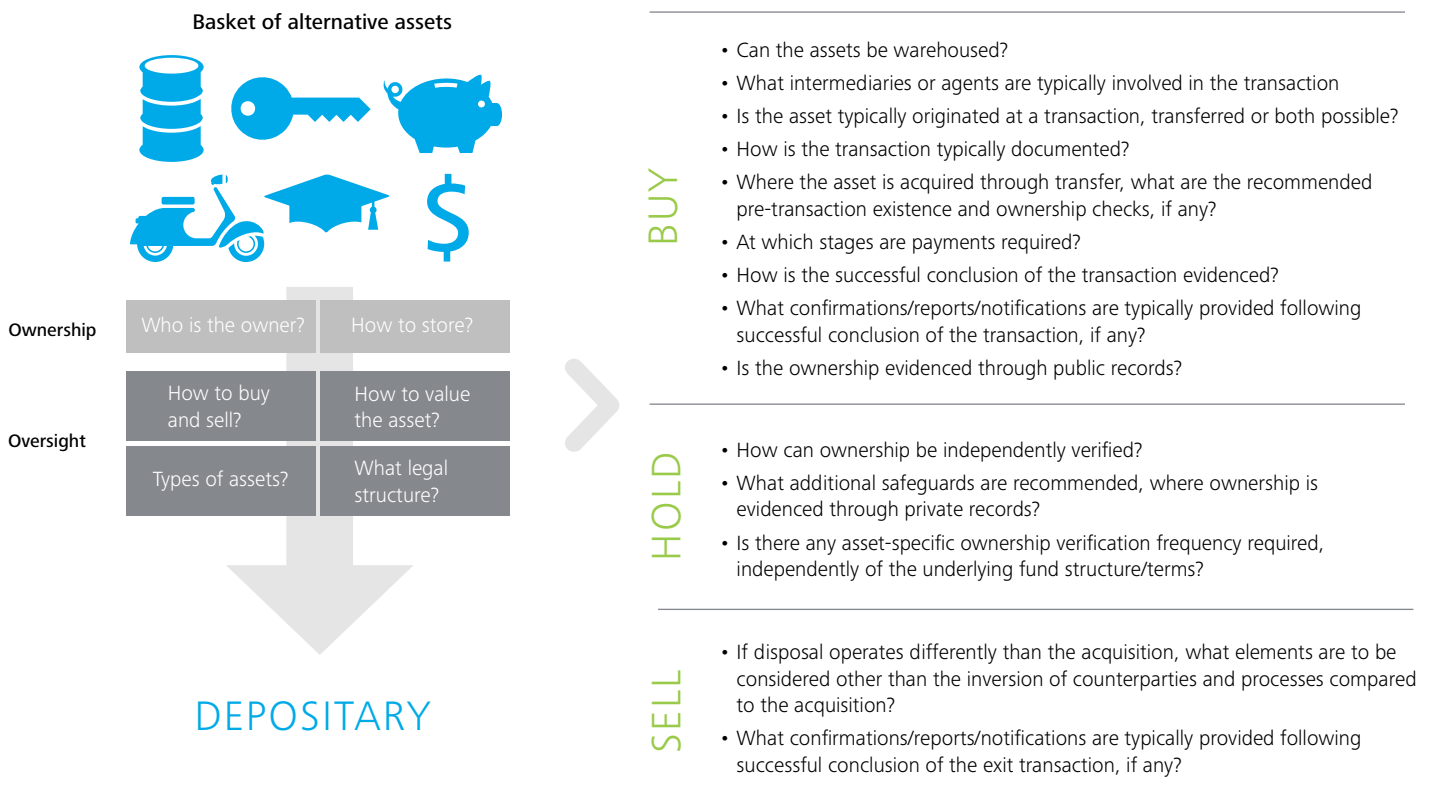
With this diversity comes an increased, if not exponential, complexity in ensuring that the depositary knows where the assets are at all times and can ensure that the AIF has full ownership of them and that the assets are kept safe.

How do you buy a race horse and how is ownership evidenced in a secure way? Which intermediaries are involved in the transaction and is there a central and public register that can hold up in court? How does this differ from one country to another? How can you be sure that the race horse named in the ownership titles is actually the race horse standing in the stables? How should the race horse be looked after so that it keeps its value?

Which stables are suitable and offer the best protection for the horse, and how can the stable be monitored in order to ensure that the race horse does not disappear or become injured or sick? How is the value of a race horse established, and which factors influence the value and hence call for a re-assessment of its value?

The entire thinking, acquisition and record-keeping process initially designed for financial products needs to be adapted to such an asset class. Ultimately, investors should benefit from equivalent due diligence from the depositary regardless of whether their assets are financial instruments or not.

Answers to these questions might sound obvious. They are not. Addressing them in a professional manner across the entire value chain and in line with the notion of a depositary of assets under AIFMD requires the thorough understanding of a highly specialised service provider and robust processes that are fully adapted to the specific needs of an asset class. Both large banks and small firms will face considerable operational challenges in order to meet special depositary requirements.



### The emergence of the new PFS status...

Dealing with financial assets and ensuring that title of ownership is always clear is part of the day-to-day business of credit institutions. But the sheer diversity of non-financial assets creates many challenges and complexities for depositaries who must fulfil their duties in an AIFMD environment. Indeed, specialists need to be called upon when it comes to non-financial assets.

AIFMD gives member states the option to allow the depositary of certain AIFs to be a professional entity which does not necessarily qualify as a bank or an investment firm.

With the transposition of AIFMD into Luxembourg law through the law of 12 July 2013, Luxembourg has exercised this option by introducing a new category of specialised PFS (Professional of the Financial Sector) to the Financial Sector Act of 5 April 1993. The new category is called 'professional depositary of assets other than financial instruments', or more commonly 'special depositary'. To this end, article 26-1 has been added to the Financial Sector Act.

As diverse as non-financial asset classes might sound and appear, they have a set of common needs and this is where the special depositary comes into play—the requirement to ensure that the AIF has a clear title of ownership to the assets that is properly registered and documented and that, above all, the assets are safeguarded in order to preserve them. Obviously, preserving race horses is a totally different business to preserving fine wines, and needs a completely different understanding and infrastructure in order to ensure that they are kept safe in line with legal requirements.

Furthermore, the complexity of tasks to be performed by the special depositary is often increased by the use of complex financial engineering arrangements, where assets are held indirectly by the AIF through special purpose vehicles (SPVs).





Asset types and likelihood of positioning for a Depository							
Type of assets	Example of assets	Depository					
		Major players specialised in asset servicing			Niche players		
		H	M	L	L	M	H
<b>Financial assets</b>	Shares	[Green shaded area]			[Green shaded area]		
	Bonds						
	UCI units						
<b>Non-financial assets</b>	Private Equity	[Green shaded area]			[Green shaded area]		
	Real Estate						
	Life settlement policies						
	Gold						
	Diamonds						
	Infrastructure						
	Watches						
	Art/Paintings						
	Intellectual property						
	Race horses						
	Petrol						
	Fine wines						

... provides the AIF with several options to appoint a depository

The creation of the special depository licence gives AIFs several options when appointing a depository and they also call for credit institutions to rethink their business models. The special depository can either be appointed directly by the AIF, or act as a delegate of the AIF's single depository. It may, however, only be appointed as a special depository of Specialised Investment Funds (SIF), of Investment Companies in Risk Capital (SICAR) and other Luxembourg or foreign AIFs as per the AIFMD, provided that these have no redemption rights exercisable for at least five years from the date of the initial investment and mainly invest in assets that cannot be held in custody or invest in issuers or non-listed companies as a means to acquiring control over these.

A key element in identifying whether a depository and/or a special depository may be appointed obviously lies in what the AIF invests in.

An AIF mainly investing in financial assets will probably appoint a credit institution with a network of cash correspondents and sub-custodians as its single depository.



But does a credit institution also have enough knowledge and the appropriate organisational structure to deal with assets such as race horses, fine wines, diamonds or physical petrol? Probably not, not to mention the fact that preserving race horses is a totally different ball game than preserving fine wines and needs a completely different understanding and infrastructure to ensure that they are kept safe in line with legal requirements.

So where do we draw the line? Will the AIF have to appoint a credit institution as depositary, which in turn delegates the part of its duties relating to non-financial assets to a special depositary? Or can the AIF actually choose not to appoint a credit institution at all as depositary?

Under EU Regulation 345/2013 of 17 April 2013 on European Venture Capital Funds (EuVECA), qualifying funds must invest at least 70% of their assets in venture capital or private equity and actually do not need to appoint a credit institution as depositary.

On the basis of this, we consider that AIFs investing at least 70% of their assets in non-financial instruments should be able to appoint directly a PFS as its special depositary.

The supervision of financial assets requires that a standard network of sub-custodians and cash correspondents be set up and maintained for assets which are not part of the core activities of a PFS. By delegating the safekeeping of these assets to a credit institution, the PFS could focus its attention on a niche market by supervising non-financial assets.

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Dealing with financial assets and ensuring that title of ownership is always clear is part of the day-to-day business of credit institutions

### Banks and PFS's need to position themselves

Many AIFs have for long not been required to appoint a depositary. This has now changed with AIFMD being in force since 22 July 2013 and has placed a considerably large number of funds under stringent regulations. As a result of EU-wide access of AIFs to investors and the requirements of the AIFMD, there is a considerable business opportunity for service providers, provided they carefully evaluate how to place their bets:



- Banks will need to understand the current and future needs of their clients and decide whether to stick to the traditional safekeeping of financial assets or seize the considerable business opportunities offered by servicing non-financial assets.
- PFS's are much smaller players, often well established in the alternative investments space. Their smaller size allows them to easily adapt to new needs, and offer tailor-made services focusing on the specific needs of AIFs. Seizing the opportunities offered by the new special depositary means positioning itself as the best possible partner of AIFs or credit institutions for that array of non-financial assets.

Furthermore, the broad framework provided by the Financial Sector Act actually allows a PFS to combine the special depositary licence with other licences, such as registrar and transfer agent, fund administration, domiciliary and corporate agent, or communication agent, and hence offer a comprehensive end-to-end solution to its clients.

- The new special depositary licence, in combination with the reputation of Luxembourg as a service centre of excellence and a hub for international distribution, will in our view make it more attractive for new players to enter the market fight for market share.
- Banks, PFS's and new market entrants alike are well advised to carefully evaluate which part of non-financial assets they want to specialize in, as covering too many distinct asset classes risks diluting its competence in servicing them properly.

Although the AIFMD distinguishes between financial instruments and non-financial instruments held by an AIF, a single depositary can obviously hold both. However, given the complexity and the need to specialise illustrated above, there is considerable demand for specialised providers.

We particularly see the competitive advantage of crafting a holistic service proposal of several licences and offering comprehensive solutions tailored to the needs of an AIF.

	Major bank players	Niche players	Unconventional players
<b>Strengths</b> 	<ul style="list-style-type: none"> <li>• Larger capacity; integrated approach with full scale service offering</li> <li>• Infrastructure to attract and absorb critical mass</li> <li>• Larger network and broader client base to leverage marketing and relationships</li> <li>• Ability to accommodate lower fees or subsidise some services</li> </ul>	<ul style="list-style-type: none"> <li>• Dedicated personnel; more customer focus</li> <li>• Flexibility in offering customised services</li> <li>• Strong player among smaller asset/wealth managers and family offices</li> </ul>	<ul style="list-style-type: none"> <li>• Entering the regulated fund market and competing with banks</li> <li>• Often strong expertise in unregulated market (e.g. Soparfi)</li> <li>• Expertise in local regulatory reporting and accounting</li> <li>• Flexibility in offering customised solutions</li> </ul>
<b>Weaknesses</b> 	<ul style="list-style-type: none"> <li>• Limited service customisation or inertia in delivering on promises</li> <li>• Lesser customer focus</li> </ul>	<ul style="list-style-type: none"> <li>• Limited network; difficulty to attract critical mass</li> <li>• Limited range of service offering</li> <li>• Difficulty to compete with lower administrative costs of larger competitors</li> </ul>	<ul style="list-style-type: none"> <li>• Lesser automation; processes are generally manual; i.e., less efficient</li> <li>• Limited range of service offering (e.g. no custody services)</li> </ul>



### What is in it for Luxembourg?

Luxembourg is a well-established financial centre for servicing investment funds. The presence of a vast array of custodian banks, fund administrations, consulting firms and support service providers creates a unique environment of excellence and know-how that combines multilingual staff with experience in servicing funds from all over the world and covering all asset classes.

Luxembourg's creation of the special depository licence as an extension of the Financial Sector Act addresses this market need perfectly. Now it is up to market participants to identify the potential, define their value proposition and above all position themselves as a provider of choice. Custodian banks, established PFS's, niche players as well as new market entrants should start preparing now.

### How Deloitte can help?

Deloitte helps AIFMs in navigating through the regulatory challenges of obtaining a licence, distributing their funds in the countries of choice, and adapt the product range to the new requirements.

We help service providers, such as PFS's and credit institutions, in defining their business and operational models in an ever changing landscape and this allow them to seize new opportunities and grow their business.

With our deep industry knowledge, we are uniquely positioned to provide strategic, regulatory, tax and business advice and help our clients create value for their organisations.



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Ultimately, investors should benefit from equivalent due diligence from the depository regardless of whether their assets are financial instruments or not





# Demystifying Change Management

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As you are sure to have noticed, change has become a ‘way of life’, with ‘change management’ being a recognised discipline for 30 years now. Despite significant investment and literature on the subject, most studies still show a ‘60-70% *failure rate for organisational change projects - a statistic that has stayed constant from the 1970s to the present*’<sup>1</sup>.

Why is it so difficult to manage, implement and successfully master change? Could change resistance have been invented by managers in order to justify their potential failures? Could the ever-increasing degree of complexity related to organisational transformations be the main cause of this challenge?

Three decades of experience later, the assertion that ‘*today’s world of business is not just changing – it’s transforming*’<sup>2</sup> has created an urgent need to apply some self-analysis, and potentially discover the seeds of a new change dynamic.

Common misconceptions about change management lead to a superficial approach to change initiatives. We will now look at each of these in turn with a view to demystifying change management.

<sup>1</sup> <http://blogs.hbr.org/2013/04/change-management-needs-to-cha/> - Harvard Business Review, ‘Change management needs to change’ by Ron Ashkenas

<sup>2</sup> Inside, CIO edition 2013, ‘CIO as Chief Innovation Officer’



### 1.1 Exploring strategic change

#### Misconception #1: We need to change because everyone is doing it

Charles Darwin wrote that evolution advances by means of natural selection. In organisations, this is commonly referred as the 'change or die' rule. Change is natural, implicit and – according to Darwin – is needed to move forward or even survive in some cases.

But at first, many organisations go full-steam ahead to design their strategic change plans without taking the relevant time to consider the fundamentals. What does the organisation want to preserve? *'Know thyself and you will know the Universe and the Gods'*<sup>3</sup>, by analogy an organisation would largely benefit from first thinking 'values' before thinking 'change'. Before 'knowing how' to change, then, the question of 'why' we have (or want) to change our strategy has to be carefully considered and answered in terms of objectives to be reached.

'Change for its own sake' (or because competitors do so) cannot be a valid argument. The link between the change effort and the organisation's strategy is essential.

The stakes are high: it is the starting point of the change initiative. It is of paramount importance that everyone holds a common understanding of the objective(s) to be reached. Not only are the organisation's mission/objectives used as a point of reference during the very useful diagnostic exercise, but they also play a key role in filtering activities throughout the change management process.

An organisation will integrate changes only if it considers that those changes support the organisation in reaching its main and specific objectives. Successful change requires development of a context-sensitive approach. Only under those conditions can employees' behaviours be adapted and changed.

<sup>3</sup> Precept of the Delphic oracle which Socrates passed on to his followers.

### **Misconception #2: Senior management alone can define what and how to change**

One of the most critical factors in change management is leadership. There is a correlation between leadership's commitment to the proposed change and the achievement of planned outcomes and benefits. It is commonly admitted that the leaders of an organisation (senior management) are the architects of most strategic changes. We are convinced that the process of defining the nature of the change and its strategic direction is often more important than the content of the strategic direction itself. A participative approach at this stage leverages the implementation of strategic changes. Vision means nothing if it is not shared within the organisation.

By involving middle management and operational teams (including opinion leaders) when defining strategy, senior management can take the first step towards a successful change initiative. It creates powerful buy-in at early stages from the bottom up. Thanks to this participative approach, senior management will then be able to choose the most satisfying solution from the information available and take a position on the questions: where could we go, where can we go, where do we want to go?

### **Misconception #3: Individuals are more manageable than teams in a change context**

A transformation initiative is affected by the number of people required to execute it. Considering the implementation of change at an individual level is restrictive. Indeed, teams of people working together are a necessary prerequisite for overcoming organisational challenges.

An organisational entity is composed of those three dimensions: the organisation, the team and the individual. Often the 'organisation' and the 'individual' dimensions are considered; but the leverage power of the 'team' dimension is underestimated. Every organisation should invest time considering and developing an approach to each of those three dimensions during a change management project.

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The time when change management just became one more work-stream for every programme or project has passed. It is now time for a new way of thinking about how to get something accomplished

#### 1.2 Exploring resistance to change

### **Misconception #4: Change implementation only has downsides**

Change often requires significant investment in terms of managerial time and energy, as well as financial investment. In most cases, it is seen in a negative light. In Chinese, the ideogram 'change' is made of two words: 'danger' and 'opportunity'; in other words change is considered to be a dangerous opportunity. The 'danger' is often identified quickly, while the 'opportunities' remain more difficult to find.

It is the responsibility of each project manager to show people involved in the change initiative that there are opportunities present.

Change is about people; changing people and the way they behave requires more than a plan and changes to organisation, structures and systems. It takes discipline and courage.

People should be given the opportunity to express their frustrations. In groups of similar grades and concerns, people would be asked to provide a negative statement, and for each negative statement, they would have to provide a positive one. The objective is to let people bring their own solutions to the table.

Defining measurable indicators has proven to be another powerful way to promote change. By defining upfront the rhythm at which the change should be implemented, you are able to assess 'as of when is the change a success' and communicate accordingly with the individuals, teams and organisation.

**Misconception #5: Change resistance exists only at an operational level**

'Change resistance' commonly refers to one of the recurring problems which business executives face in relation to change. The term implies that change resistance exists mainly at an operational level. It conjures up images of strikes where workers protest against strategic changes that have been made by senior management. But is change resistance limited to workers, operational teams, and people 'from the field'?

Change resistance is also to be considered at a 'management level'.

For example, rapid technological change is forcing organisations to adopt new technologies and change the way they work and interact with customers. Changing the way people work has some impact on changing the way managers manage their team.

Both the impact and the scope of the change have to be evaluated beforehand. Depending on the context and organisational environment, a deductive (top-down) or an inductive (bottom-up) approach will be adopted.

**Misconception #6: People resist just because they are reluctant to change**

In a normal distribution, 10% of people in an organisation will always remain reluctant to change in any way. But what about the remaining 90%? People often resist because they do not see the need to change from the status quo.

When justifying why change should happen, it is crucial for leaders to demonstrate that there is an evolution, with the aim being to convince employees. The project manager needs to present the nature of the change to the stakeholders, and in particular to address it in a way that makes sense to them. The key question to ask is 'will it be enough to inspire the employees of the organisation?' Any resistance to change that is expressed is a good thing. According to Professor Alain Vas, academic director of the Change Management executive programme, LSM (UCL)<sup>4</sup>, it not only obliges management to verify and double check their propositions, but it also helps to identify specific areas of difficulty where change seems to cause issues, provides indications to the management on the emotional intensity of the employees towards the change; and finally offers a way to balance negative emotions and encourage employees to think and talk about changes that are being implemented.

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Successful change requires development of a context-sensitive approach. Only under those conditions can employees' behaviours be adapted and changed

<sup>4</sup> <http://www.uclouvain.be/formation-continue-changement.html>

<sup>5</sup> i.e. the property of a system in which variables are regulated so that internal conditions remain stable and relatively constant.

### Conclusions: challenges and next steps

Every organisation is a dynamic balance of forces regulated by the principle of 'homeostasis'<sup>5</sup>. When explained in this way, it can be understood that change resistance is an absolutely normal reaction, as well as why change management has become a key managerial skill.

A change programme or project requires a clear leader with the power to act, as well as clear project managers with change management skills. The time when change management just became one more work-stream for every programme or project has passed. It is now time for a new way of thinking about how to get something accomplished.

The challenge is to make change management part and parcel of the business plan, and not an add-on that is managed independently. Of course, success requires changes in behaviour from all project team members.

In the 5th century, the Greek philosopher Heraclites stated that 'the only thing permanent is change'. Change is a recurring and inherent part of life, which is why organisations have the 'dangerous opportunity' to embrace change. Effective change management implementation requires analysis, mobilisation and implementation; but it is pre-eminently a mind-set, a permanent intellectual exercise. We should accept it and move towards an increasingly successful change effort.



# Talent Challenges in FSI

## Designing responsive solutions through workforce analytics

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The Financial Services Industry (FSI) is going through turbulent times. Leaders are striving to restore their profitability and brand status while being forced to reinvent their business to face up to structural changes in the external environment.

In this context, having the ability to both reduce costs and attract and engage talent critical to their core business is not only a key strategic requirement but is also a source of competitive advantage. The time to prepare for future challenges is now. Despite this, talent management programmes too often fail to demonstrate why they are required and how they can generate a return on investment. This is a cause for concern as talent is a vital component of an organisation's adaptability and future growth. Workforce analytics that investigate current and future talent challenges can provide assistance for designing responsive talent solutions that have an impact on the bottom line.

**Talent is critical to enable and drive strategic change**  
Today's executives are struggling to find the appropriate balance between cutting and managing costs while investing in and developing new markets to remain competitive. In addition, structural changes in their environment are gradually calling their historical strengths into question. Indeed, the economic environment and regulatory pressure are forcing them to open up to new and global markets as well as to shift their strategic priorities to new client segments and distribution channels: FSI has moved into a new business world.





FSI organisations have embarked upon a transformative journey to adapt their service offering and operating models to the 'new normal' and prepare for future growth. During this period of strategic change, talent management is critical to ensuring that the organisation has the right people, in the right place, at the right time and at the right cost to deliver on the strategy. As firms are increasingly competing on knowledge and intangible assets<sup>1</sup>, the ability to attract and engage critical skills is also becoming a source of competitive advantage and should be a central strategic priority.

In addition, companies will need talents with adaptive and proactive minds to enable and drive strategic change within the organisation. In a period of constant change and uncertainty, organisations need to be:

- *Adaptive*: they should be able to modify or remodel and adjust their actions for a different purpose.
- *Pro-active*: 'A plan never comes together'; therefore, firms must be able to prepare for, intervene in, and control unexpected situations. They need to anticipate obstacles.
- *Responsive*: Being responsive and reacting quickly can make all the difference.

To face up to these new requirements, companies will need to review their traditional ways of approaching talent management.

This change will require even more effort and investment from a financial industry facing tough challenges in the talent arena, with change in social attitudes strongly impacting its reputation and attractiveness.

Indeed, banking is a less popular career choice today than in 2008<sup>2</sup>, with remuneration practices coming under increasing regulation in the banking and investment management sectors. In other words, companies need a valuable talent management strategy that can develop their attractiveness and compensation structures that are in line with the rest of the market.

Moreover, talent management will also help organisations that must overcome key people challenges to ensure their sustainability.

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**FSI organisations need to re-skill their employees in order to satisfy more demanding clients, adapt to quickly evolving and complex products as well as to develop new markets**

<sup>1</sup> *Disrupting the CHRO: Following in the CFO's footsteps*, Deloitte University press, January 2014  
<sup>2</sup> *Generation why? Attracting the bankers of the future*, Deloitte Talent in Banking Survey 2013

### Talent Management is required to overcome talent challenges in FSI

Adaptive and responsive talent management is required for FSI organisations to address three main people challenges: (1) new skills are needed to adapt to the new business world; (2) handover planning and knowledge transition are required to anticipate changes relating to workforce demographics and expectations; finally, (3) organisational restructuring is needed to face up to changing business requirements and strategies.

#### Need for new skills

FSI organisations need to re-skill their employees in order to satisfy more demanding clients, adapt to quickly evolving and complex products as well as to develop new markets.

For example, private banks are increasingly focusing on (ultra) high net worth individuals and emerging markets as future areas for growth. Clients are also asking for bankers who have deeper technical knowledge of portfolios of products and services. Meanwhile, insurers are finding themselves in need of more highly-skilled individuals to handle the advanced data analytics and predictive models being deployed throughout their operations. The whole FSI industry also needs new skills to comply with increasingly complex regulatory and financial reporting requirements.

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**FSI organisations have embarked upon a transformative journey to adapt their service offering and operating models to the ‘new normal’ and prepare for future growth**

As a result, despite high unemployment rates, many bankers, insurers and investment managers are finding it very difficult to fill critical positions requiring specific skills at a reasonable cost. In this context, a well thought-out talent management approach can help organisations anticipate their needs and therefore quickly align talent acquisition and development actions with strategic objectives.

#### Handover planning and knowledge transition

While looking for new skills, companies are also struggling to retain their existing ones due to a combination of workforce demographics and retention challenges. Current workforce demographics create significant challenges in terms of handover planning and knowledge transition. When experienced employees retire, firms face a significant risk of losing a wealth of knowledge and skills. Meanwhile, new generations are entering the workforce and moving into management positions. Companies must find an effective way facilitating this transition.

In addition, the financial sector is becoming less attractive for younger generations of workers and is facing a retention issue. Companies need to restore their employer brand and quickly find new solutions to attract and retain talents. This also involves adapting to the needs and expectations of a new generation of around 2.3 billion active workers<sup>3</sup>.

Forward-looking talent management therefore becomes crucial for helping executives anticipate future changes and also contributes to the organisation’s sustainability.

<sup>3</sup> *All work and all play*, Box1824, 2013

<sup>4</sup> *Talent Edge 2020: Blueprints for the new normal*, Deloitte University Press, 2011

<sup>5</sup> *Op. cit.*

### Organisational restructuring

Economic downturns lead to organisational restructuring. Shareholders put pressure on costs, leading to outsourcing or offshoring of certain activities to markets with lower labour costs. In this context, organisations are cutting employee numbers and programmes or initiatives that cannot show a clear return on investment.

Although business leaders recognise their importance, talent management programmes are too often considered as pure cost and abandoned as organisations fail to demonstrate their direct return on investment. Indeed, in 2011, only 6% of FSI executives ranked *'acquiring and developing leaders and talent'* as a key priority compared to 27% across all industries and 25% of FSI executives in 2009<sup>4</sup>.

Therefore, FSI executives must find a way to demonstrate the ROI of developing and implementing talent management programmes and turn them into a strategic source of competitive advantage.

### How workforce analytics can provide assistance for designing efficient talent solutions

Why is workforce planning analytics key to building efficient talent solutions? The answer can be summarised as follows: 'One size does not fit all!'

In fact, each organisation faces different choices depending on its size, market and contingencies. In a complex and rapidly changing environment, organisations cannot rely on standard models alone when addressing their talent challenges; they need to develop a deep understanding of their business issues and root causes to take focused actions and monitor their outcomes. Deloitte research<sup>5</sup> shows that, in the financial industry in particular, the top talent management programmes rely on metrics.





#### **What is workforce planning and analytics?**

Analytics is the discipline of turning data into information and finding relevant and useful insights from that information to drive business strategy. Workforce analytics focuses on the people side as a main area of decision. It helps executives and talent managers to make decisions more accurately, objectively and economically. Indeed, research shows that the most mature companies in terms of talent analytics are the highest performing companies in terms of shareholder value<sup>6</sup>. Moreover, workforce analytics can help executives and talent managers to create a business case for talent programmes.

Workforce planning is a specific application of workforce analytics which is particularly relevant to addressing the current talent challenges of the financial sector. It is the process of monitoring, estimating and forecasting talent requirements to achieve business objectives. Put simply, a workforce planning approach enables informed and proactive decisions regarding the company's 'build, buy, borrow' strategy.

It focuses on answering the following business questions:

- Which critical skills will be required within the next 3-5 years to implement our strategy and what is our action plan for attracting, retaining or developing them?
- How can we guarantee knowledge retention when people are retiring or leaving due to workforce reduction plans?
- How can our company remain attractive and maintain employee engagement in a multi-generational and post-financial crisis employment market?
- How can we ensure that our workforce is of an appropriate size in the context of our strategic reorganisation programmes?
- Which leaders will we need in the future and how should we start to develop them now?

The implementation of a workforce planning capability is very often seen as too complex and consequently not considered to be a priority. Although it is not an easy journey, it is becoming an increasingly important requirement in the era of 'Big Data' and can be facilitated via a structured and focused approach.

<sup>6</sup> *The datatification of HR, Deloitte University Press, January 2014*

**Figure 1: talent analytics maturity model**



Note: Percentages indicate the proportion of the 480 surveyed organisations performing talent analytics at each maturity level

Source: The datatification of HR, Deloitte University Press, January 2014

### Designing an efficient workforce analytics approach

Organisations should first understand where they stand in terms of talent analytics capability and then decide their target maturity level (see figure 1): the greater the level of talent analytics sophistication, the higher the strategic alignment.

To maintain efficiency and strategic alignment, workforce planning should be focused on critical business issues and key workforce segments and structured around a top-down approach in accordance with the following steps:

- Start with the business objectives and related critical workforce issues. Focus on workforce segments with the highest impact on company strategy and whose skills are difficult to replace.
- Understand the information and data required. Look for any present and historical, internal and external as well as quantitative and qualitative data that might be relevant for plotting the trends of workforce supply and demand.
- Glean insights from the data. Analyse data objectively and check your understanding to avoid misinterpretation. Analytical tools may be required to build scenarios with a high volume of diverse data.

- Turn insight gained into informed decisions and an action plan. Understand the key workforce gaps and challenges that you will face in the future and decide on an action plan to address them.
- Evaluate the outcomes of your actions and improve analyses and plans accordingly. Workforce planning is a continuous process and involves a progressive implementation and learning approach.

### It is time to grasp the importance of talent analytics

As highlighted above, organisations have yet to grasp the strategic importance of talent management and demonstrate its return on investment. The best business strategies cannot be put into action without talents. In particular, the financial industry is facing such challenges in terms of future market positioning, search for competitive advantages and talent acquisition and engagement that it would be unrealistic not to consider talent as a strategic driver and invest accordingly.

We believe decision makers should consider workforce planning and analytics to be a key enabler in their strategic change journey. The ability to rely on numbers and facts and to tailor the approach to the specific features of each organisation facilitates the design of the most adaptive and responsive talent solutions.

Organisations must start building their workforce analytics capabilities today, so that they are prepared for the challenges of tomorrow.



# Financial crime compliance It is no longer sufficient to ‘go it alone’

**Luc Meurant**

Head of banking markets and  
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SWIFT

Multiple factors make compliance with financial crime legislation one of the most difficult challenges facing the chief operating officers of banks and other financial institutions today.

First, the penalties applied for non-compliance are steep and only getting steeper, with billions of dollars of fines levied in the last 15 months. More costly still is the remedial expense of improving processes and adding personnel to cope with the increased workload of preventing such action in the future. It is important to note that these costs are not limited to institutions that have been cited for violations; it is safe to say that nearly every financial institution is spending substantially more on financial crime compliance-related activities compared to just a few years ago.

This picture is further complicated by the diverse and constantly evolving nature of financial crime, including the fact that the rules differ across major jurisdictions and are subject to regular change. COOs face the reality that financial crime compliance is much harder to measure than other aspects of operational risk, making it more difficult to define meaningful benchmarks for ‘what good looks like’.

### The cost of doing business

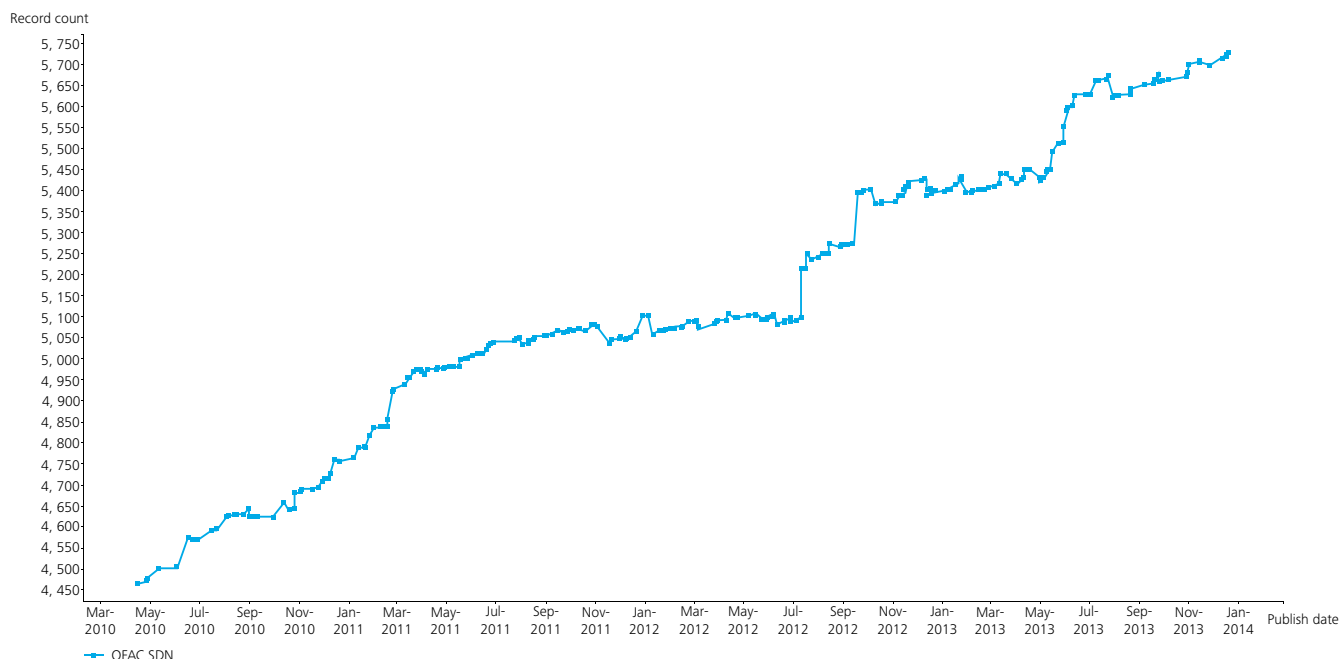
Banks must accept that compliance is an essential pre-requisite of doing business. However, a combination of high stakes, fast-evolving risks and an absence of best practice has resulted in a ballooning of banks' compliance budgets, but with no real certainty of success.

In July 2013, a global survey of 300 senior compliance executives at financial institutions conducted by Veris Consulting found that 57% of respondents had increased their anti-money laundering and Office of Foreign Assets Control (OFAC) compliance budgets in the past 12 months. But almost a third said they still felt their budgets were 'inadequate or severely inadequate'. This is further confirmed by a global survey of financial institutions released in December 2013 by *BAE Systems Applied Intelligence and Operational Risk & Regulation magazine*, which found that half of respondents expected to increase investment in compliance by 20%.

With regulators frequently raising their expectations in terms of sanctions compliance and the definition of non-compliant transactions subject to interpretation, banks must make their own decisions on the investment levels, policies and procedures that must be adopted to avoid falling foul of financial crime legislation.

For example, regulators expect banks to prevent transfers involving individuals cited on a sanctions list, regardless of the many possible ways their name might be represented (even a first name can have many variations, e.g. Bob, Robert, Rob, Bobby, before initials and titles are even considered), which means that each bank must decide how far they should deploy technologies and techniques to comply with sanctions rules.

Figure 1: sanctions list growth - OFAC SDN



### Measuring the unmeasurable

In this context, banks' compliance budgets are potentially limitless. Not only does increasingly sophisticated technology need to be applied to screen greater numbers of transactions, but more staff are required to analyse the alerts thrown up by the technology.

Within most areas of banking operations, metrics have been developed to accurately measure effectiveness. But in a low-probability/high-impact area such as financial crime compliance, measuring and optimising effectiveness is far from straightforward. If tighter monitoring policies increase the number of alerts investigated by your sanctions monitoring team from 100 to 120, have you actually reduced the level of compliance risk, or simply increased the team's workload and related operational cost? How do you balance the need for smooth operations and good customer service with the mandate to identify and block all transactions that might be in violation? These unmeasurables mean that the traditional COO challenge of devising strategies to improve operational efficiency, then monitoring and measuring their impact to optimise processes on an ongoing basis, is an imperfect guide to optimising financial crime compliance policies and procedures or to setting compliance budgets.

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Just because your bank's compliance challenges are unique does not mean you must tackle them alone

### The role of standardisation

A further difficulty facing COOs is that regulatory supervision in financial crime compliance is evolving more rapidly than most tools and solutions can handle. Automation is essential of course, but it requires continual investment. Over the past decade, increasingly advanced technologies have been introduced to support banks' compliance efforts, but these have often addressed very specific needs, leaving a very fragmented picture from an enterprise-wide perspective. This means that implementation costs typically overwhelm the prices paid for the compliance software itself, with significant resources required to upgrade, inter-connect or replace existing solutions. This also hampers second-level controls, i.e. the systems that check that compliance systems are working properly.

In addition to delivering cost-savings, the move to a more standardised approach would help banks allay regulators' concerns and support both parties' efforts to further establish best practice. The gradual standardisation of financial crime compliance policies and solutions would offer banks the opportunity to take best practice to another level.

As with any new or fast-evolving requirement, banks have tended to initially tackle financial crime compliance in their own individual way, only over time realising the inefficiencies of ploughing investment into solving essentially the same industry-wide problem. In non-competitive areas, such as compliance with financial crime legislation, this stage should come sooner rather than later. And it is beyond doubt—as Basel III and other reforms erode banks' balance sheets—that financial crime has reached the point where the need for standardised practices at lower cost brings forth the case for shifting from proprietary solutions to utility approaches.



### The move to collaborative solutions

The realisation that financial crime compliance budgets could be a bottomless pit has motivated banks to move from standalone investments to a more long-term approach, where collaboration helps the industry benchmark its compliance efforts and mutualise their cost.

Many of the benefits of the utility approach have been established in related fields of banking operations. A dedicated industry-wide utility can help to capture and define best practice and serve as a forum for further innovation, as has been seen in the evolution of message standards for example.

One area of interest to SWIFT users is that of Know Your Customer (KYC) compliance, where a number of our member banks have explicitly called for us to develop a KYC utility to help tackle this compliance burden in addition to the sanctions solutions we already offer.

Ongoing KYC compliance involves demonstrating that you have access to the relevant information about your clients, that you have put the necessary due diligence processes in place and that you have performed the necessary validation and analysis to determine the level of risk related to each counterparty.

Although KYC compliance has its most visible impact at the onboarding stage, this is just the beginning for banks, as information must be kept up-to-date and stored so it can be integrated with other sources of data within internal systems and shared with other banks when necessary. The diversity and frequency of KYC requests from third parties (where the same information may be required multiple times) means that the quality of data and data management processes are critical for efficient KYC compliance. All too often however, information requests are handled on an ad hoc—and at least partially manual—basis.

A further consideration is whether to concentrate KYC compliance so that all business units and branches follow a single centralised policy or take an approach based on meeting the differing requirements of local regulators. When you consider the difficulty in verifying that the information supplied is both accurate and up-to-date, the need to rationalise, standardise and streamline the current plethora of KYC requests and processes becomes apparent. What is more, many of the jurisdictions across which most banks operate are regularly raising the bar, tightening and tweaking policies at a rate that forces banks to develop long-term systems and solutions which enable them to adapt to the ever-moving target that is KYC compliance.



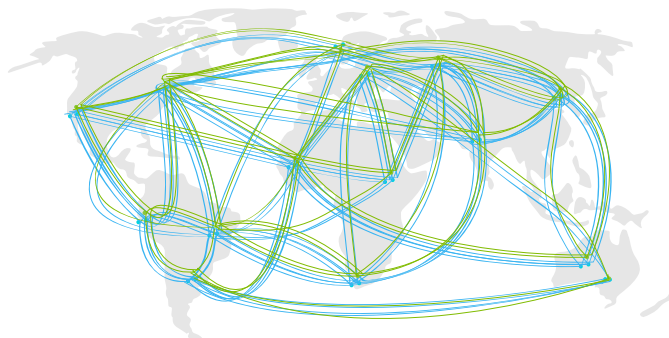
### KYC utility—prerequisites for success

The existence of a central hub to which a bank would only be required to send any single piece of information once—instead of today’s infinite number of times—would represent a significant efficiency gain for the industry. As such, SWIFT is creating a KYC registry which will help users reduce the cost, effort and risk related to KYC compliance, including tracking the validity of documents, sending reminders if documents expire and providing notifications if updated information becomes available.

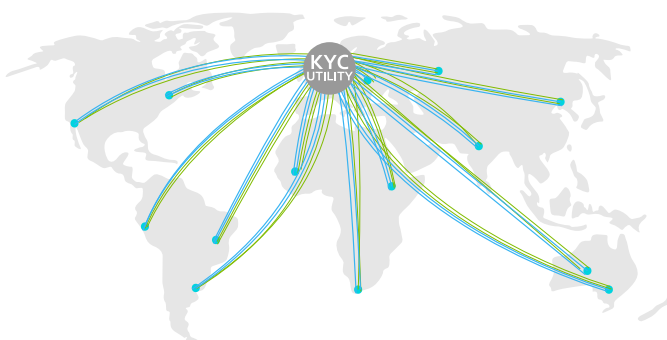
For any utility solution to be successful, several elements must be present. First, there must be an acceptance of the need for a cooperative approach among key stakeholders. Second, the utility operator must be able to create standards on which best practice can be established and innovation can flourish. Third, the utility must achieve and maintain high standards of operational excellence on which its member banks can rely. Finally, the utility must have access to the necessary skills and expertise in the field for which it wishes to provide a service.

Figure 2: KYC registry

Now



Future



Compliance will always remain the responsibility of the bank and so all utilities must be transparent in their processes and policies. This is why SWIFT’s KYC registry has established a working group of member banks responsible for validating the scope of the initiative, formalising the required functionality and, over time, encouraging participation across the wider banking community.

Ultimately of course, a utility is only a means to an end, helping individual banks meet their compliance obligations to their particular regulators by demonstrating the effectiveness and appropriateness of their processes and the systems they have put in place.

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The realisation that financial crime compliance budgets could be a bottomless pit has motivated banks to move from standalone investments to a more long-term approach, where collaboration helps the industry benchmark its compliance efforts and mutualise their cost

### The drive toward continuous improvement

The challenge for banks is to move toward a point at which their financial crime compliance measures are repeatable, predictable and aligned to their risk profile. If banks can achieve this objective, they will be better able to measure and therefore continually improve the effectiveness and efficiency of their compliance strategies. Given that continuous improvement is essential, the number of transactions requiring monitoring and the number of risks is only going to increase. If COOs are to bring their spending on financial crime compliance under control, then measuring, benchmarking and sharing best practices are essential. We believe utility solutions can and will play a key role in this area.

In summary, we sense a shift in the industry's approach to compliance, from KYC to sanctions.

We believe banks are now more willing to share, talk and be more transparent in areas where it is in their collective interest to work together on joint initiatives. Financial crime compliance is just one such area.

In addition, we believe standardised solutions will unlock economies of scale. SWIFT's Sanctions Screening product serves as a good example. Although implemented slightly differently in each instance, the same product is being used in almost 70 different countries.

This demonstrates that many of the needs of banks in complying with financial crime legislation are common and can be tackled through solutions built on standards. Just because your bank's compliance challenges are unique does not mean you must tackle them alone.



# Reliable AML controls based on complete and accurate static data An ongoing challenge for professionals

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## Context

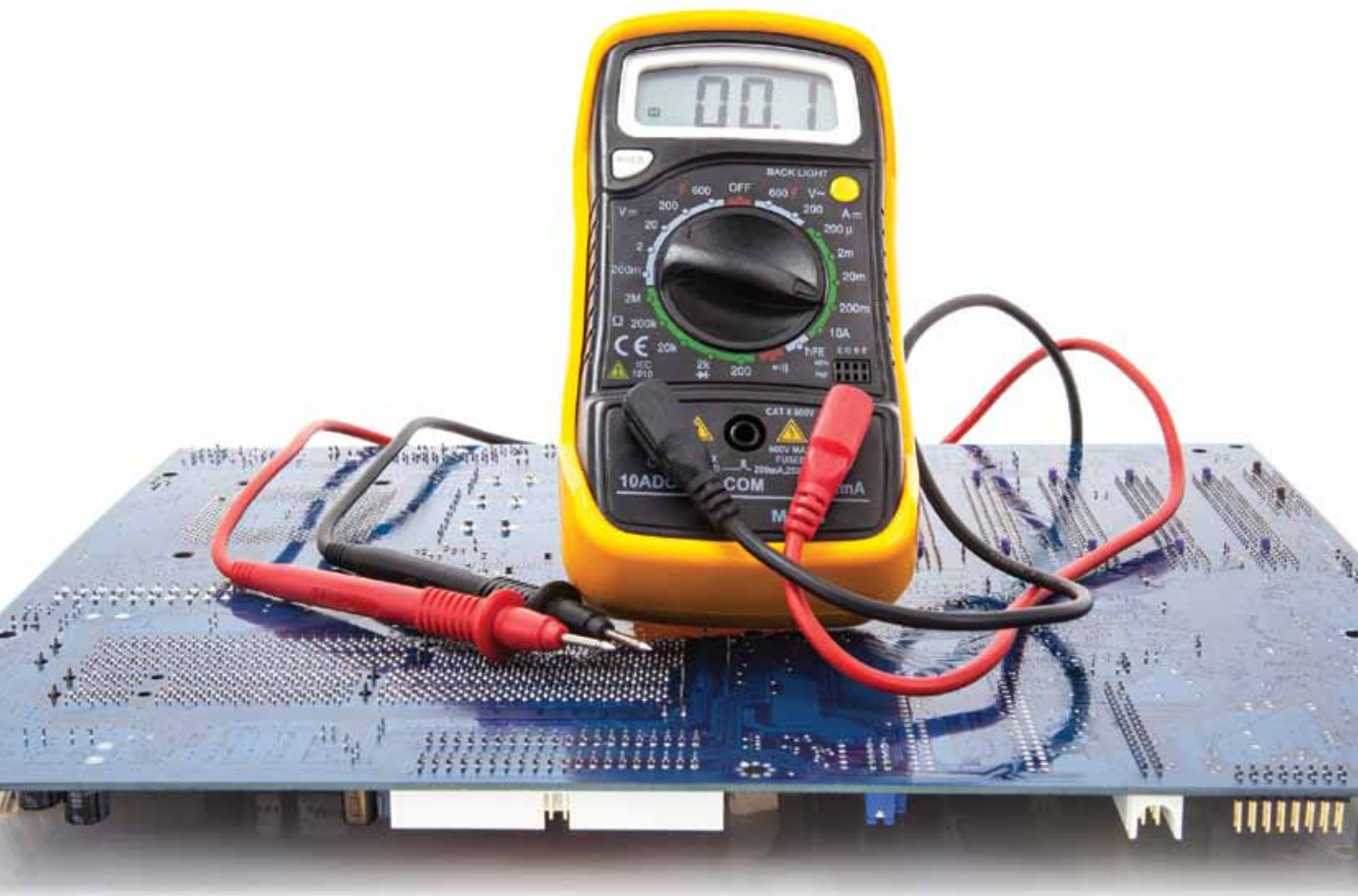
In recent months, many articles have been published by the international press about suspected cases of money laundering. The media continue to report on a wide variety of money laundering scandals.

Sanctions have also reached unprecedented heights with a record fine of USD 1.9 billion paid by an international bank in December 2012 to settle allegations of Mexican drug traffickers and terrorists using this bank to move money around the financial system.

The risks of money laundering and terrorist financing continue to top financial and political agendas and these risks fall under the scope of both internal and external audits for the financial sector. As the money laundering and terrorist financing risks encountered by professionals have evolved, the legal and regulatory framework has quickly been adapted, given increasing pressure from regulators worldwide to have professionals revise and update their controls and systems in order to fulfil their professional obligations.

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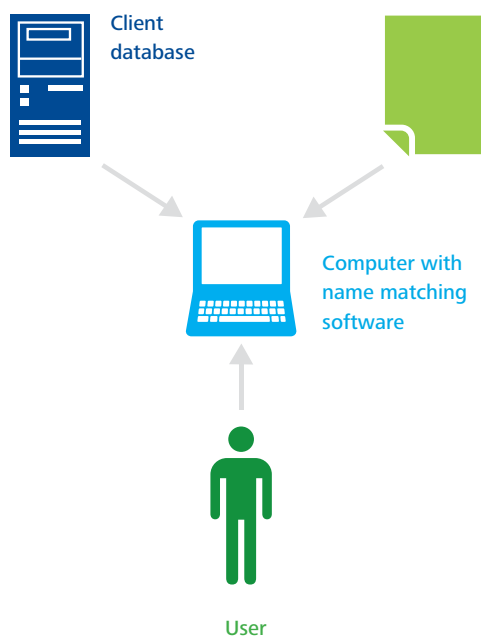
Money laundering and terrorist financing are dynamic and continually evolving phenomena that demand the vigilance of professionals, who must keep abreast of the latest developments and trends



### Importance of static data and background information

In light of the risks and challenges mentioned above, it is critical to have complete and high-quality static data, which are the raw material used for risk rating and related mitigating controls. Risk rating takes the clients' various characteristics into consideration (country, type of client, activity/industry, PEP (politically exposed person) status, non-face-to-face, etc.) as well as the type of services provided (nature, exposure, underlying assets, distribution channels, etc.) and attaches a weight to each criterion to calculate a global risk score. This is detailed in CSSF circular 11/519 or 11/529 and in articles 4 and 5 of CSSF regulation no. 12-02.

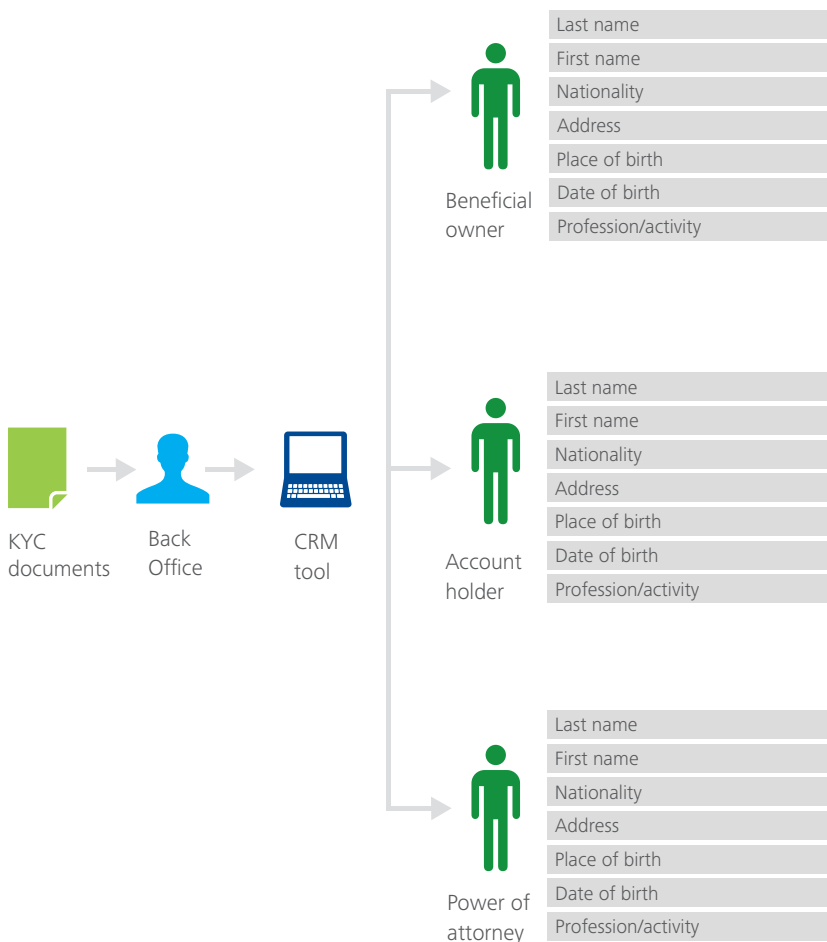
Based on this risk rating, name screening and transaction monitoring are applied with differentiated frequency. Name screening is performed both on the client database and on the electronic transfers (originators and beneficiaries).



- **Blacklists - Criminals and terrorists**
  - UN list
  - EU list
  - Luxembourg Public Prosecutor
  - Any other private lists
- **Sanction lists**
  - OFAC (Office of Foreign Assets Controls)
- **PEP lists**
  - (CIA)
  - Dow Jones Factiva
  - World Check
  - etc.

For name screening on the client database, all relevant information about the client and other related parties (such as ultimate beneficial owners, directors and authorised signatories) must be correctly and exhaustively entered into the database used for Client Relationship Management ('CRM').

Furthermore, in order to generate useful and reliable queries and statistics, it is essential to ensure that static data is in a consistent and harmonised format. For instance, if nationality data for the United States is inputted as 'U.S.', 'USA', 'United States', 'America', 'California', etc., the quality of controls is severely undermined.

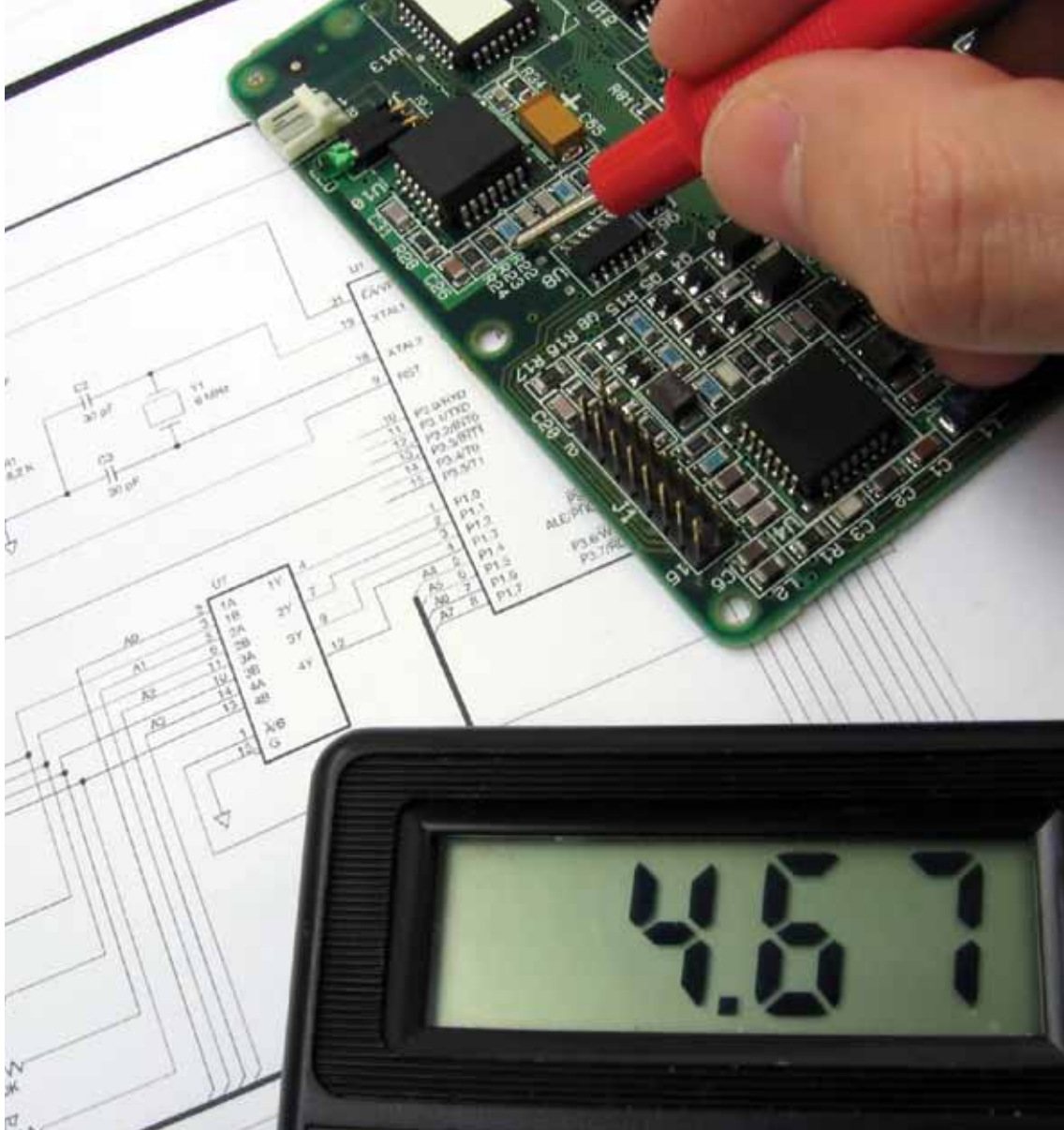


Static data corruption can occur during a Customer Relationship Management system migration given that static data relating to clients/investors and their linked parties may be altered. There is a risk that the names of clients/investors or of the persons linked to corporate accounts may go missing, or even that some clients'/ investors' date of birth may be indicated as 01/01/1900 (the system default date in the case of field format incompatibility).

Human error also regularly represents another hazard for static data. This is the case, for instance, with clients/investors going through third party introducers, whereby the names, date of birth, nationality or other information about persons linked to corporate accounts may be missing because a third party introducer did not collect this information. As a consequence, alerts may be missed or too many false positives may be generated.

*Static data is processed using name matching software that generates alerts for potential hits, which are to be reviewed by the user and classified as true or false positives. This classification is carried out using factual elements used as elements of differentiation to support the decision whether a potential hit is a 'true' or a 'false positive'. A false hit could be justified, for instance, in the case of a different date of birth or middle name. Once more, it becomes apparent that static data completeness and accuracy are critical.*

Based on static data from the client and transaction database, the transaction monitoring system processes financial flows using frequency, thresholds and rules and against predefined money laundering detection patterns.



Client data is also used when reviewing the generated alerts to analyse the coherence with the initial account purpose and expected transactions. Here, information on the source of wealth required by article 24 of CSSF regulation no. 12-02 proves valuable, as it provides the professional with a context to corroborate volume, frequency and origin/destination.

As such, ensuring the completeness and quality of static data is the first key step for professionals in order to effectively carry out their procedures and controls.

#### Remediation

Procedures and controls calling for a degree of diligence are implemented when collecting client data in order to prevent and manage the risks of money laundering and terrorist financing. New accounts are opened based on current procedures in line with up-to-date requirements for complete due diligence and KYC documentation. For existing accounts, there is a risk that information may be missing or outdated.

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In light of mentioned risks and challenges, it is critical to have complete and high-quality static data, which are the raw material used for risk rating and related mitigating controls



This risk is often the hardest to remedy, due to significant regulatory changes in recent years and the commercial difficulty associated with requesting additional information from clients in a long-standing relationship.

Remediation usually starts by reviewing the scope definition and analysing any gaps between existing KYC/AML procedures, controls, documentation and current AML professional obligations. Once the gap has been identified, tasks are prioritised in accordance with the risk attached to the incomplete files.

Procedures can first be reviewed to facilitate the analysis of account opening files, using an updated version of procedures in line with current requirements. Often, KYC files identified as 'high risk' and complex structures (offshore companies, trusts, foundations, etc.) are the main area of concern for professionals, as reviewing and remedying any risks associated to them is time consuming and involves a heightened risk of money laundering or terrorist financing.

When account opening files are reviewed, the missing information and documents are collected from relationship managers, intermediaries or clients as part of the remediation effort. The purpose of remediation is to ensure that static data to be stored in the CRM system are complete.

Deficiencies identified during the review can be inputted directly in the professional CRM or in a dedicated review tool with a separate database that will be used during the remediation effort to update the static data.

The lessons learned from file reviewing and remediation assistance exercises show that the main issues are those presented by information and supporting documentation relating to the source of wealth, both for individuals and legal entities as well as the beneficial owner structure for legal entities.

Using knowledge from relationship managers and Open Source Intelligence<sup>1</sup> ('OSINT'), a large proportion of the deficiencies can be solved with no or limited information requests to the client. The information collected can be complemented by a memo with all the available information and all field research, visits or verification that the professional has performed to corroborate the client's explanations.

The upside of such an exercise is that the professionals improve their knowledge of the client, which can be later turned into a commercial opportunity.

Remediation also deals with missing or incomplete name screening and transaction monitoring. Remediation is required for clients for whom no recent name checks have been performed or exception reports were not properly followed up, the latter being the worst-case scenario.

The remediation exercise shows differences in the way the name is spelt, in the first/middle name, country, date of birth, place of birth, country, occupation, etc., thereby supporting a classification as a false hit or leading to a Suspicious Transaction Reporting. In the case of a real hit, the nature of the hit is analysed (PEP, individual, crime, terrorist, etc.) as they do not all have the same impact and consequences. Some might trigger a Suspicious Transaction Report (STR) to the Public Prosecutor. The professional then adds a comment to explain the impact on the risk rating and the relevant action.

<sup>1</sup> Open-source intelligence (OSINT) is intelligence collected from publicly available sources.



### KYC is still a hot topic

Money laundering and terrorist financing are dynamic and continually evolving phenomena that demand the vigilance of professionals, who must keep abreast of the latest developments and trends. Preventing money laundering and terrorist financing remains a major concern due to the inherent threat it can pose to the integrity of legitimate financial institutions and the financial risk of severe penalties and the legal ramifications it represents. With complete and updated data, however, professionals of the financial sector are better equipped to detect and manage the risks of money laundering and terrorist financing.

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The risks of money laundering and terrorist financing continue to top financial and political agendas and these risks fall under the scope of both internal and external audits for the financial sector



# LEI

## The 4G of transparent market data

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### Introduction

When the G20 met in Pittsburgh in the wake of the financial crisis, the focus was on remediation. To counter the shocks that the system had suffered, a mechanism was to be put in place to monitor counterparty risk exposure. It had come as a shock to many, including (one suspects) regulators, that the extent of the potential problem was not identified before it emerged as a series of domino-like failures. In that rather sobering environment, it is not surprising that there emerged a firm desire and commitment to ensure that such a situation should never arise again and that transparency should be brought to the markets.

Much of the groundwork had been laid in earlier summits; indeed, when one reads the Pittsburgh communiqué with the benefit of hindsight it is clear that in the collective minds of the G20, the focus had already switched from design to implementation. As a whole, the measures foreseen by the G20 articulate well into a coherent and comprehensive framework.

They create transparency and traceability through a hierarchy of identification, and implement practical measures for each subject to use that transparency for practical purposes. In practical terms, the G20 agreed on the principles and then left the trading 'blocs' concerned, the USA and the EU being those amongst the first to act, to determine and enact legislation allowing the detailed requirements to be implemented.

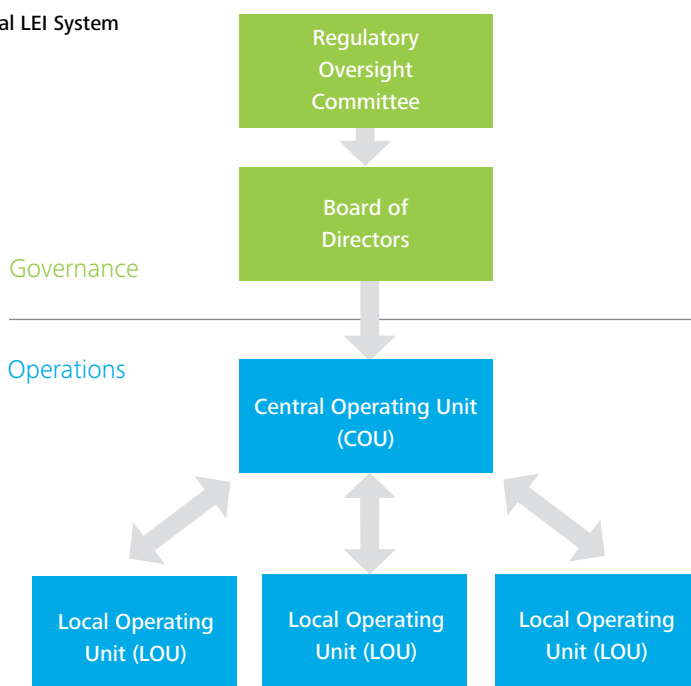
The G20 mandated the Financial Stability Board (FSB) to work on the long-standing industry need for a unique, global and standard Legal Entity Identifier (LEI – the cornerstone of traceability), in order to help assess systemic risk and aggregate risk at an entity level. The FSB set up the ROC (Regulatory Oversight Committee)<sup>1</sup> and defined the format for a standard LEI and a global, federated approach to distributing LEIs.

The idea was a brilliant one. A system to identify market participants and their trades would be created to ensure that at all times the interlocking and overlapping exposures would be clear for all, including competent authorities which could then monitor and if necessary take action to ensure market stability.

<sup>1</sup> Open to all states and state sponsored entities with a view to establishing a global and unique framework to attribute identifiers to all market participants.



**Global LEI System**



- International financial market regulator
- Upholds governance principles and oversees that global - LEI system functions in the public interest
- Plenary and Executive Committee

- Oversees functioning of the COU, operational integrity and implementation, maintenance of standards specified by the ROC
- Appointed and overseen by ROC, composed of stakeholders from financial and non-financial firms

- Ensure application of uniform operational standards and protocols to maintain unique LEIs and high data quality
- Manage federation through LOUs
- Maintain central logical database

- Provision of LEI functions
- Service providers, local business registries, numbering agencies

Within the initial documents setting out the competence and purpose of the ROC was the basic framework the ROC was required to establish and oversee: a governance structure which itself would be supported by a Central Operating Unit (COU) into which would feed national or local operating units

#### Legal versus operational identifier

Unfortunately, the processes were not clearly articulated, or rather the all-important interaction between interlocking initiatives was left almost to chance. Pittsburgh threw together a number of considerations and ideas, not all of them necessarily aligned or thought through to their logical conclusion and not necessarily all grounded in fact. From the outset, the project was heavily weighted towards the banking industry, less so towards corporate and not at all towards investment funds or other market participants. Considerations for the latter and the impacts that certain requirements might have on them only emerged later on the learning curve on which all those involved embarked.

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The financial crisis has brought Data Quality Standards back under the spotlight. With EMIR support, the LEI is expected to be the first piece of this data review puzzle

In parallel to the construction of the governance structure for LEIs, legislation was being drafted that would use the LEI for practical purposes. The first manifestations of this being EMIR in Europe and the equivalent derivative clauses of Dodd Frank. The goal of EMIR and Dodd-Frank is to be able to tell and understand who is holding what exposure to any particular financial sector, instrument or counterparty. This process starts with the LEI and then extends outwards to the use of unique product and transactional identifiers—the UTIs, UPIs and USIs, among others, of which one now hears so much.

The very name given to the future identifier – the Legal Entity Identifier – gives rise for concern. Depending on how broadly or narrowly it is defined, it could disenfranchise entities completely by not considering them as eligible for an identifier if they have no specific legal status (the case strictly speaking for contractual funds and certainly for co-management or pooling arrangements). In many ways it is unfortunate that the word 'legal' found its way into the requirement; it may have seemed logical and self-evident from the point of view of the FSB and the G20, but has inevitably resulted in a lot of reflection and unhelpful complications when it has come down to concretely attributing identifiers to entities that were already considered by markets as bona fide counterparties. The problem centred on the fact that the definition debate was taking place at several different levels of granularity and at different points on the implementation timeline.

### The implementation process

The intended structures of the ROC and infrastructure to support the LEI are clear, but they have yet to be put in place. The ROC is in the process of empowering the formal Board and its governance remit, there is no COU (Central Operating Unit) as yet and those LOUs that have been recognised are still in the process of migrating from 'pre-LOU' to 'full LOU' status. For every acronym associated with the process there is a 'pre' stage, meaning there are 'pre-LOUs', 'pre-LEIs', etc.

This was a time pressure-motivated development, as financial markets could not wait for the ROC to design its perfect model and yet at the same time were dependent on the ROC's blessing of grassroots initiatives for them to mature into workable solutions.

It has been up to the market to put together workable solutions within very basic parameters. This is particularly the case for designing the means of recording and registering transactions themselves. There may yet be problems of divergence in the implementation of the measures using the LEI, and even of the LEI itself.

One not insignificant matter may concern the COU—the Central Operating Unit. It is perhaps regrettable that this key function has been left almost to last in the evolution of the LEI system; regrettable, but almost inevitable. Had the process been given the time to mature from ROC down to LOU before a single LEI was issued, not only would a significant time delay have increased the risk of interim measures being introduced to facilitate EMIR and Dodd Frank alike, but moreover, the lessons learnt along the way in the ad hoc process would have had to be learnt once everything was set up.

The probability that intent and practice would be incompatible in those circumstances would have been increased exponentially. However exactly what the role of the COU should be is still a matter of muted but crucial debate. Should it be, as some would see it, a facilitator promoting bilateral links between LOUs, potentially playing the role of arbitrator should the need arise?



Or should its function be a controlling one, as those more familiar with planned economies – or rather economies that hanker for a high degree of central planning and intervention – might prefer? And should the primary communication channels be between LOUs with the COU as a central co-ordinating and information centre, or should all communication pass from LOUs to the COU for onward transmission? These may be minor points, but they could be crucial in determining how smoothly the system works over time.

On a more practical level, there is divergence of approach regarding one sided or mutual reporting. The United States is happy with a system whereby one counterparty reports on behalf of both and is generally dealer driven.

Europe has opted for a mutual reporting approach, with each party responsible for reporting its own transactions and having the possibility to delegate the function itself but not the responsibility to a third party.

At first glance, mutual reporting may suggest a higher degree of safety (and this is probably central to the European thought process), but there are certainly arguments for and against both approaches.

Notwithstanding all these considerations, pitfalls and difficulties, a system is emerging. The framework of the LEI is there at least and markets are responding to the challenges of creating legislation-specific identifiers to forge the link between LEI and transaction-level reporting.

#### DFA versus EMIR approach

The most disquieting divergence that appears when one examines the detailed comparative requirements of EMIR and the equivalent provisions of Dodd Frank is one of approach. It is clear that Dodd Frank is looking to transparency as a means of ensuring that the market operates efficiently and smoothly, with an emphasis on speed and full reporting to allow the market to converge on pricing and standardisation. The EMIR approach (with its delayed reporting and more extensive data requirements), crossed with AIFMD reporting, appears to focus more on market abuse and its prevention. It will be interesting to see how these objectives play out over time; in the short term they will present particular challenges for those operating cross-border and across regulations.

### An additional twist to consider: AIFMD\*

In isolation, ESMA's decision to use the concept of the LEI to drive AIFMD reporting requirements is logically impeccable. It is clearly within the intent of the FSB and other bodies to work towards a global system of identifiers, and indeed had a decision been taken to use anything other than LEIs it might have been felt that the validity of the whole concept was being called into question.

However, where this introduces an extra level of complexity rather than smoothing the path to coherence is that, beyond the narrow confines of EMIR and the equivalent OTC-related tenets of Dodd-Frank, little concrete progress has been made on the broader framework of the LEI and certainly not with respect to definition. In addition, in invoking the 'LEI' in this context ESMA gives no more than minimal guidance as to how this requirement fits into the overall LEI initiative.

As already discussed, major practical progress has only been made concerning the allocation of de facto pre-LEIs by pre-LOUs in the hope that these initiatives will be approved and validated by the ROC. Clearly, as these initiatives were driven by the immediacy of first U.S. and now European OTC derivative reporting, the focus has been on that sector of the market. There has also been some reflection as to the applicability of 'counterparty' rather than purely 'Legal' (entity identifiers) to accommodate contractual funds, limited partnerships, etc.

The result is that AIFMs and AIFs (entities that have no contact with or activity in derivatives markets of any sort), notably private equity and real estate managers, will be required to contact LOUs set up specifically with EMIR or Dodd Frank in mind to obtain an identifier in the coming months. The lack of familiarity on both sides of the process will be another learning curve on which the broader industry must embark.

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To counter the shocks that the system had suffered, a mechanism was to be put in place to monitor counterparty risk exposure



Beyond the immediate information and operational considerations behind this process, the potential use to which data stored under LEIs will eventually be put should be kept in mind. EMIR and Dodd Frank aim at bottom-up transparency, building a picture of counterparty exposure from the level of the transaction itself (albeit with a top-down hierarchy of identifiers). AIFMD is looking to aggregate transparency at Manager (AIFM) level.

It is unlikely that analysis of data sourced using the two approaches will provide a coherent picture from the outset, especially as the common point of reference – the LEI – is not exclusive. Not all transactions reported under EMIR will be related to an AIFM, far from it. Nor will it be possible to determine which transactions have been aggregated from the LEI alone as used under AIFMD. Without doubt, reporting and coherence will require additional work before truly usable data emerges. Hopefully regulators will not jump to hasty conclusions in interpreting apparent patterns.

#### The way forward for phased quality improvement

In a changing regulatory landscape, organisations need to take immediate steps to assess the impact on their risk and regulatory reporting processes. When adopting the LEI, organisations will have to ask themselves a number of questions:

- Which parts of the business are most affected by LEI? (starting with client on-boarding, data management, regulatory reporting and risk management processes)
- Which business processes could be affected and what are the costs and benefits of LEI adoption?
- What are the secondary impacts of LEI adoption in one process but not the other?

In addition, these key elements of an LEI adoption programme should include the assessment of current (regulatory) initiatives affected by LEI (particularly in the risk management function) and analysis of systems holding client and counterparty data.

In the context of BAU integration, it will also be essential to develop processes to update, match and streamline existing data, while incorporating the LEI.

The LEI clearly entails significant business process, but also implies technology changes across all business lines. Organisations will need to understand what being 'compliant' means for them and determine their approach for achieving such compliance. Using a phased approach, market participants will need to prioritise and execute significant change activities (across data, technology, process and organisation) in line with their agreed strategy, whilst maintaining BAU.





### Conclusion

The LEI is complex and challenging. Its implementation is made all the more challenging by the stop-start way in which EMIR reporting has been a dependency of other elements (authorisation of Trade Repositories etc.). There are risks and issues ahead as the market works through the supporting elements and regulators work on the conundrum of understanding the picture that the data they receive really represents.

#### **But the process also offers opportunities**

The use of the LEI will undoubtedly improve the ability of supervisors to monitor systemic risk. Moreover, it is a tool to improve risk management within organisations. Organisations with a consistent and accurate group-wide view of their clients and counterparties could improve risk management and their sales and take-on processes, strengthen finance processes and reduce the operational costs associated with downstream impacts of inconsistent and inaccurate data. However, existing data stores (operational, accounting and risk infrastructures) will first need enhancement to integrate the LEI.

The financial crisis has brought Data Quality Standards back under the spotlight. With EMIR support, the LEI is expected to be the first piece of this data review puzzle. Embedding the LEI in product and front line systems presents an opportunity to secure greater straight through processing (STP), to reduce operational costs and the need for reconciliation between data sets that are similar but different (owing to data quality and consistency improvements). Organisations that embrace this opportunity will become more agile and ready for more proactive management of their activities and counterparties.

Above all, it is essential that all concerned take a step back to consider the long-term impacts of the LEI and the big picture to which it has been introduced. Many decisions are being taken to meet immediate reporting obligations; it would be a lost opportunity if those decisions, taken in haste, were not revisited and were allowed to obscure the advantages that enhanced market transparency has to offer.

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A system to identify market participants and their trades would be created to ensure that at all times the interlocking and overlapping exposures would be clear for all, including competent authorities which could then monitor and if necessary take action to ensure market stability

# FATCA

## The final stretch before going live

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Over the last few years, the trend of global tax transparency and exchange of information has had a considerable impact on the financial industry. With the entry into force of the Foreign Account Tax Compliance Act ('FATCA') withholding tax on 1 July 2014 and the imminent signature of the Luxembourg inter-governmental agreement (IGA), the Luxembourg financial institutions will make a leap towards the world of information exchange. FATCA calls for a completely new mindset to be adopted when doing business and will impact most actors in financial institutions.



The relevant Luxembourg financial institutions will have to comply with the FATCA requirements as implemented into local law. The operational implications should differ slightly depending on the business concerned, as illustrated in the following example.

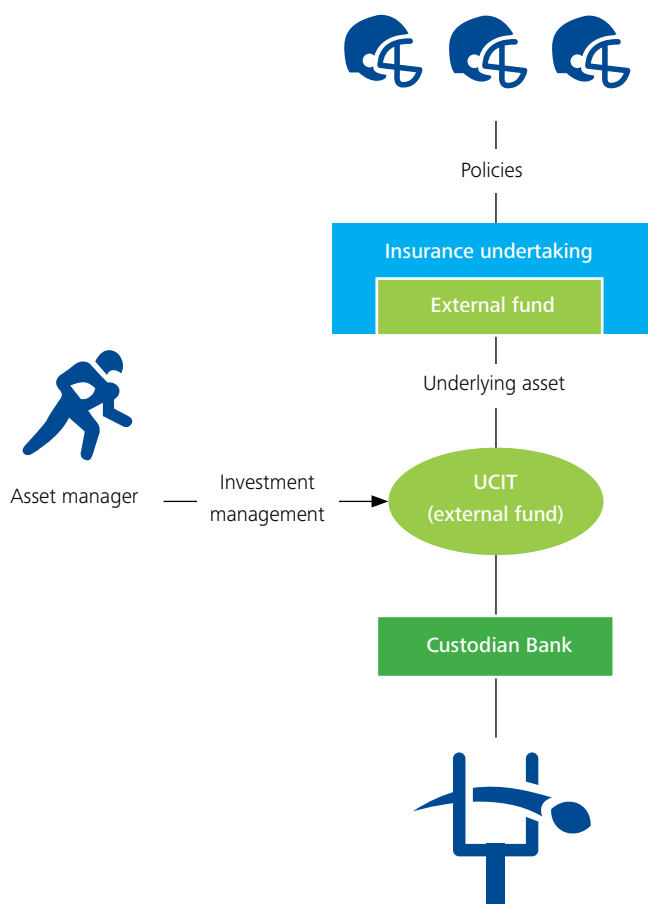
In the example on the right, the insurance undertaking, investment funds, asset manager and custodian bank would be considered as FFIs (Foreign Financial Institutions). The majority of actors within these organisations will participate in the FATCA project.

**Risk and compliance teams**

The responsibility of registering the entities will most likely fall to the compliance teams, who would also need to implement policies and procedures to enforce the FATCA requirements within the organisation. At a later stage, they will need to provide for internal controls on such FFI requirements.

**Registration (depending on the entity's status)**

The above-mentioned market players should all be Reporting Model 1 FIs by default (since Luxembourg will sign a Model 1 type IGA implying the automatic exchange of information between the Luxembourg tax authorities and the US tax authorities (IRS)). Nevertheless, the FATCA law as implemented in Luxembourg will grant certain deemed-compliant statuses under conditions (entities subject to less stringent requirements as they present a lower risk of assisting tax evasion). Deemed-compliant status should be limited to remote cases within the banking and insurance industries in Luxembourg.



However, investment funds can choose from several possible deemed-compliant statuses, such as Collective Investment Vehicle status<sup>1</sup>. As these deemed-compliant entities would mainly be Non-Reporting Luxembourg Financial Institutions, they would not need to register.

Consequently, Luxembourg FIs should first be able to determine their status (which must be validated by management) and corresponding registration options. The compliance teams will, where required, register the entity according to its chosen status. They will need to complete and submit their registration, certifying that all information provided during the registration is valid. The person providing the certification can be (but is not necessarily) the Chief Compliance Officer. The sole requirement is that such a person has sufficient authority to enforce the FATCA requirements within the organisation. Nominating a FATCA Responsible Officer, as required under the final regulations, will not be mandatory in Luxembourg (as an IGA Model 1 country), but further guidance in this respect may be brought by the local implementation law.

#### **Implementation of policies and procedures, and internal controls**

The FATCA requirements (as detailed below) will need to be properly enforced within the organisation. In this respect, procedures should be implemented in order to formalise the various classification, withholding, reporting and internal control processes resulting from FATCA. Going forward, the detailed due diligence and classification process to be established should indeed be clear and form an integral part of the account opening process.

In the case of non-compliance and material failure in the execution of its obligations, the Reporting FI also runs the risk that the IRS may request a withdrawal of its compliant status, in which case the entity would become a Non-Participating FFI. As a result, the implementation of a compliance programme and internal controls is highly recommended.

#### **Legal department**

Luxembourg financial institutions should also consider amending some of their legal documentation, such as General terms and Conditions and contracts (e.g. custody agreements, life insurance policies). These documents should clearly emphasise the financial institutions' obligations under FATCA and their consequences for clients. US clients under the FATCA law will be reported by the financial institution to the Luxembourg tax authorities, who will in turn report the information to the US tax authorities. In the event that clients are non-compliant financial institutions (NPFIs), Luxembourg financial institutions will also need to levy a withholding tax on payments of US source income and to report the payments made to the Luxembourg tax authorities. These obligations should be made clear to clients in order to avoid any future challenge from clients or commercial issues.

Given the administrative burden that certain client types present, you may also consider how the FATCA status will impact the acceptance of certain individuals or entities as clients: do you intend to continue servicing US clients or NPFIs?

#### **Front office and client relationship management**

FATCA will notably require that an extended due diligence procedure is applied to the financial account holders (as defined by the Law) for all FFIs in order to identify any potential US accounts (individual or entities). As a result, the full involvement of front office teams is necessary to comply with due diligence requirements.

The definition of US accounts is very broad indeed and also relates to US nationals living abroad, green card holders, etc. The notion of financial accounts will obviously differ depending on the business concerned. It ranges from deposit or custodial accounts for banking institutions, to cash value insurance policies for insurance undertakings and even equity and debt holders for investment funds. This due diligence will be required for pre-existing accounts (opened before 1 July 2014) with an extended period in order to facilitate the documentation and identification of such accounts, where required. Due diligence will also apply to any new accounts opened after 1 July 2014 and will necessitate the immediate identification and classification of the accounts.

<sup>1</sup> A Collective Investment Vehicle is a regulated Luxembourg investment fund which is held or distributed solely through compliant entities.

### Remediation of existing clients/investors

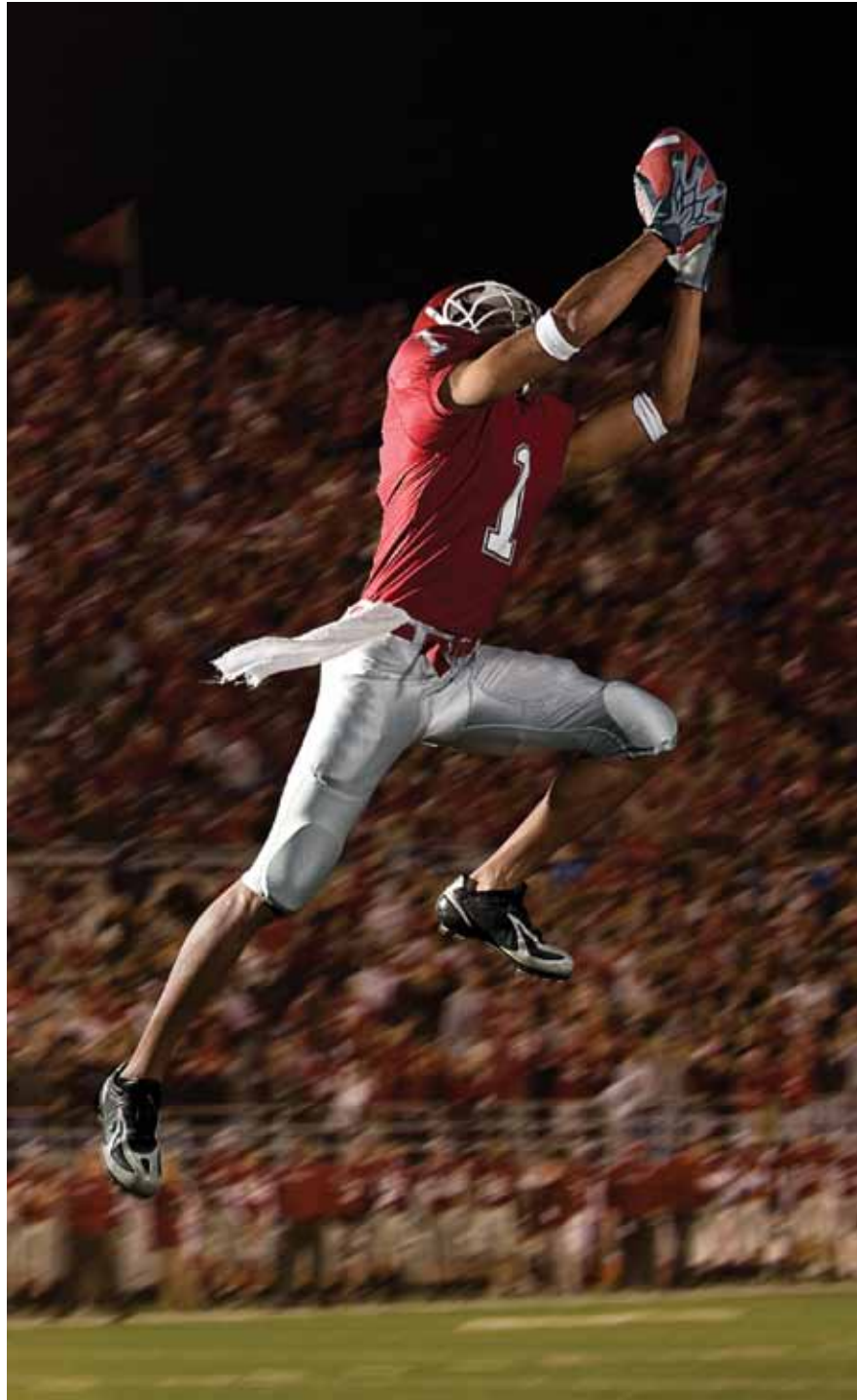
All Reporting Model 1 FI will review their existing client base in order to search for certain defined US indicia and to classify entities based on FATCA principles. Specific requirements foresee either a search of the entity's electronic database (if the account balance is below the USD 1 million threshold) or a more thorough search of all paper documentation on file for accounts above the threshold. In certain businesses where a relationship manager is appointed to the account (e.g. banking institutions), the relationship manager's knowledge also has to be taken into account. Providing front office teams with thorough training is therefore recommended, as well as documenting when the relationship manager has no 'reason to know' that the information provided to them is incorrect. In case of any US indicia, additional documentation must be requested from the account holder, in which case front office teams will need to play an active role in obtaining such documentation from their existing clients.

### External communication plan

In order to inform clients and investors about your new obligations as Reporting Model 1 FIs and request additional documentation from them, you will need to ensure a relevant communication plan is in place. Luxembourg financial institutions will also have to implement processes to manage potential questions from clients in this regard and collect and follow up documentation.

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The relevant Luxembourg financial institutions will have to comply with the FATCA requirements as implemented into local law



Clients and various other counterparties will also need to be informed of the new processes and requirements. Clients' and counterparties' jurisdictions should be taken into account when drawing up the communication plan. Indeed, reporting and withholding obligations apply for non-participating FFIs clients and should affect FFIs established in non-IGA countries and countries which have not signed an FFI agreement. Similarly, entities having certain deemed-compliant statuses in non-IGA countries will have a GIIN to provide to the Luxembourg financial institutions (because they will be registered). Conversely, entities having the same status within an IGA Model 1 country will not necessarily have a GIIN number (they may not need to register depending on the country's requirements). As a result, cross-border situations will bring an additional complexity in the application of the FATCA provisions.

In the case of the example above, the custodian bank should obtain self-certification from the investment fund in order to document its FATCA status. Within the investment management industry, this due diligence on pre-existing accounts also initially calls for assistance from certain investment funds' service providers, such as management companies or transfer agents. For insurance undertakings, this step requires either the policyholder or the beneficiary of an insurance policy to be nominated as an account holder: who will be entitled to access the amount foreseen by the contract or change a beneficiary under the contract? If the policyholder is a non-US individual who has a US address, the account will show the presence of US indicia. The insurance undertaking will have to ensure a self-certification form is collected from the account holder confirming its non-US status.

#### **Modification of client acceptance procedures**

Regarding new accounts, these indicia will need to be verified when accounts are opened. Indeed, Reporting Model 1 FFIs will need to evidence their due diligence in order to anticipate potential future audits by the Luxembourg tax authorities. In this respect, Luxembourg financial institutions should enquire, inter alia, about an individual's US place of birth, a possible dual nationality, US address or power of attorney granted to a person with a US address, etc. Luxembourg financial institutions will also need to obtain a self-certification of an entity's FATCA status (either as participating FFI, deemed-compliant FFI or non-participating FFI). This self-certification may be replaced by the traditional official US forms (in English language only) to be completed by the clients depending on their status for US tax purposes: W-8BEN, W-8IMY or W-9 forms.



### IT infrastructure and development

Luxembourg financial institutions should consider how to store all the additional documentation that will be needed further to the implementation of FATCA. Indeed, US indicia and new data storage should be considered for documentation/know your customer tools. Current systems will need to be updated, either through internal development or releases provided by your IT service provider.

Luxembourg financial institutions will also need to assess the extent of the reporting they will be required to file, in order to address the need for reporting solutions. The same assessment should also be made for the withholding tax that they would need to compute. Nevertheless, only certain FFIs (mainly banking institutions already having the primary US withholding responsibility under a QI agreement) will actually need to levy the withholding tax themselves. All other FFIs will provide their upstream custodian with withholding statements indicating the prorata of withholding tax to be levied on certain accounts/amounts. Reporting and withholding (including withholding statement issuance) processes and solutions will need to be defined in order to avoid manual processing. Reporting solutions and data format may be imposed by the Luxembourg tax authorities in the future.

### Tax and finance departments

As indicated, the Reporting FIs will have to apply the FATCA withholding tax in certain cases: where an FFI that was also a QI already had US withholding tax responsibility in the past, it would also need to levy FATCA withholding tax on US source payments made to Non-Participating FFI clients as of 1 July 2014. Non-Participating FFIs would be entities located in a non-IGA country that have not entered into an FFI agreement with the IRS. Entities located in IGA countries would only become Non-Participating FFIs in the event of material failure in the execution of their obligations and after the end of a certain period provided for by the Law.

In practice, in Luxembourg (an IGA Model 1 country), only QIs having assumed primary withholding responsibility or partnership acting as withholding foreign partnerships would actually withhold the taxes. Once the situations/accounts on which withholding tax is due have been determined, the back office teams (trade execution, securities department) would need to ensure that such withholding tax is indeed levied on the payment. If the FFI does not have the responsibility to withhold the tax itself, it then needs to issue withholding statements for the sub-custodians.

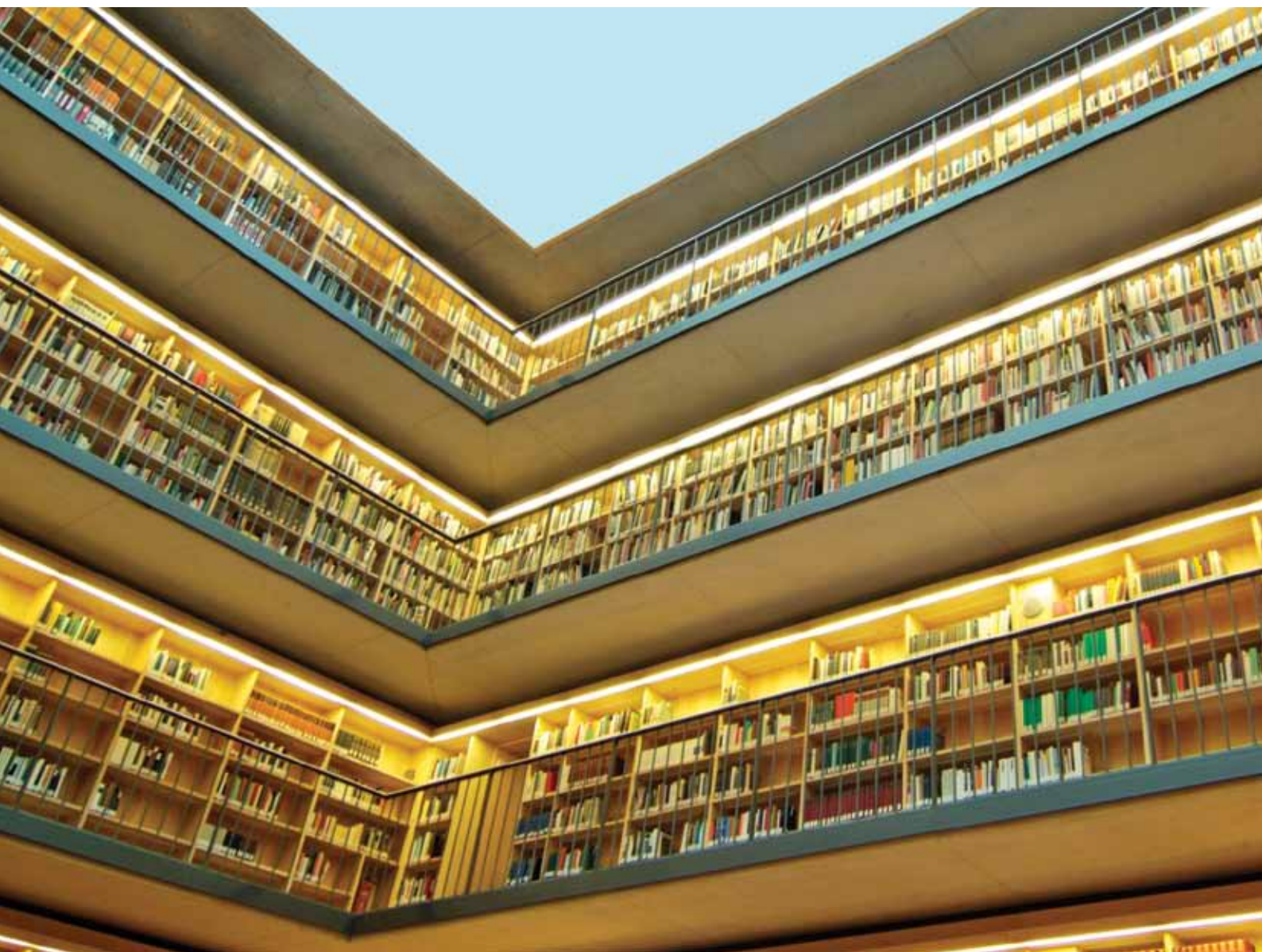
The tax department would need to provide reporting on the US accounts to the Luxembourg tax authorities. Within an investment fund context, the reporting may lead to additional complexity depending on whether the fund registers at umbrella or sub-fund level (for reporting purposes, the investments would need to either be aggregated or not depending on such choice).

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The responsibility of registering the entities will most likely fall to the compliance teams, who would also need to implement policies and procedures to enforce the FATCA requirements within the organisation

The article was written in early February 2014 and does not take into account the last updates regarding FATCA. On Thursday, February 20, 2014, the U.S. Department of Treasury ('Treasury') and the Internal Revenue Service ('IRS') released **final and temporary regulations** ('**Temporary Regulations**') that revise and clarify FATCA regulations. The Treasury and IRS also released temporary regulations coordinating the final regulations under Chapters 3 and 61 of the Internal Revenue Code ('Code') with the final FATCA (Chapter 4) regulations ('**Coordination Regulations**').

More information on <http://www.deloitte.com/lu/otn/fatca050314>



# VAT data management, with or without ERP A key challenge for wise COOs

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Tax data management is a crucial task for companies. In the current fiscal environment and considering the increasingly high number of VAT audits, it may be wise to conduct a serious check of the VAT data available in the system.

Experience shows that VAT data management is a particularly thorny issue. There are a number of possible reasons for this, but the nature of the tax itself is likely to be the central issue. VAT is a transaction tax, meaning that the data to be collected in order to prepare and support the VAT-related returns and appendices is very specific. For indirect tax purposes, this data may be completely different to the usual information that is easily found in financial statements.

For example, a company has to know and keep record of the following for VAT purposes: the place where the recipient of a service is established, the location of the goods when a sale takes place, the VAT identification number of customers, the identification of the physical flow of goods, etc. Gathering this standard basic information is often difficult in itself but, depending on the operational model and/or if the company belongs to an international group, collecting and storing the relevant information for VAT purposes can be extremely challenging.

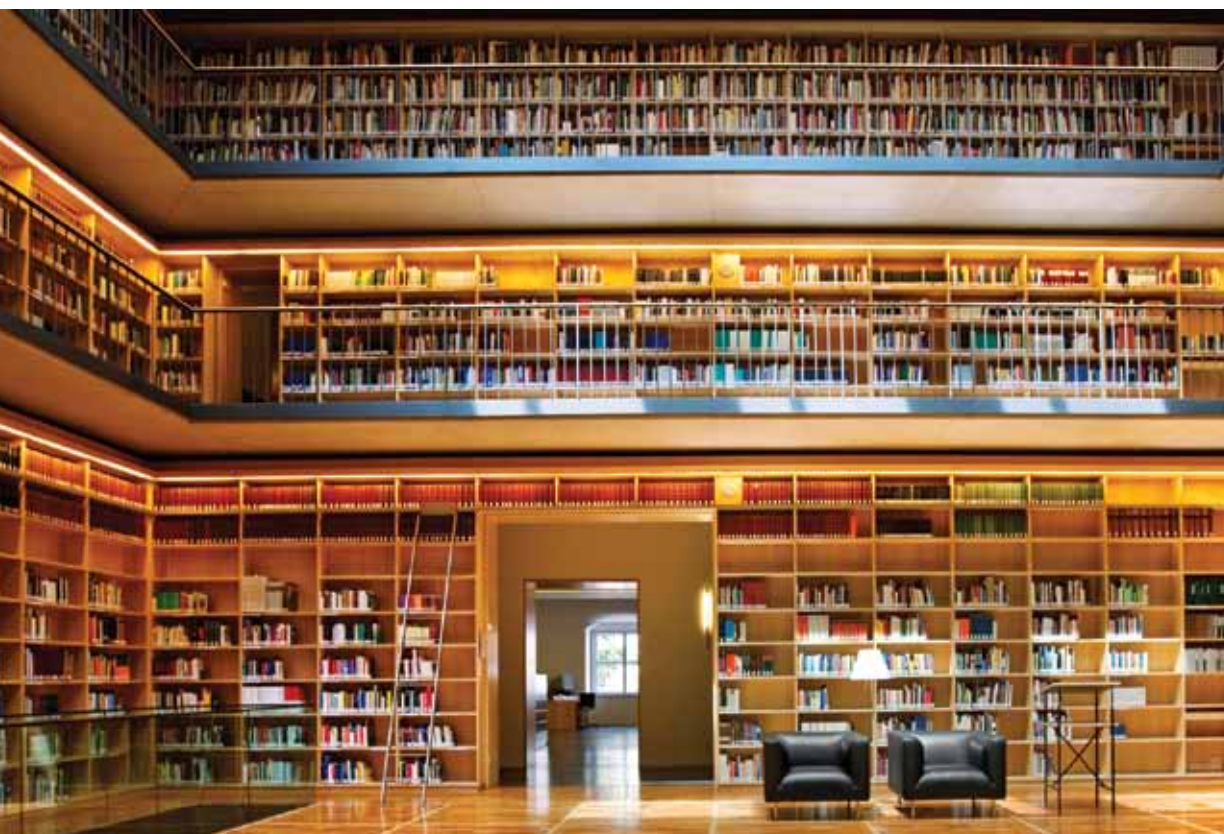
As the highest-ranking executive responsible for the day-to-day operations of a company, a COO must be aware of these possible difficulties and pitfalls. A quick overview of European-level VAT compliance requirements illustrates how challenging VAT data management can be.

The European VAT Directive, while requiring taxable persons to submit VAT returns, currently allows member states to determine the content and submissions. This results in 28 very different VAT returns with anything from fewer than 10 boxes to 100 boxes to be completed. The European Commission is currently working on a standardised VAT return providing a simpler structure and uniform information and deadlines for VAT declarations across the European Union. The idea is to allow all businesses to provide standardised information to each member state submitted in a common preferably electronic format. The aim is to implement this standardised VAT return on 1 January 2017.

According to this draft directive, the standard VAT return will only include seven basic mandatory items. However, each member state may require additional standardised information (19 different additional items). There will be no single or fully standardised VAT return across the European Union, and businesses will still have to identify the information they need to provide in their VAT return for each member state.

However – and this is the main goal of the draft Directive – , once the accounting system is set up and ready to collect the seven mandatory and 19 optional items for each member state, reporting this information in any VAT return should in theory be much easier.

In practice, apart from in the rare instance where a business conducts a single activity in a single country, gathering the relevant data could be difficult for various reasons.



In any case, the nature of the information to be collected means that companies – regardless of their size – will not simply stumble upon the relevant VAT data in their accounting systems. Action must be taken.

Companies must ensure that the VAT data is not lost, forgotten or merely ignored from the outset. It is therefore highly recommended to have clearly identified who is responsible for gathering the VAT data and to ensure that the relevant individual in the organisation is familiar with VAT data management rules.

Identifying the relevant VAT data to be collected in relation with both the payables (providers) and receivables (customers) by each of the company's entities is of the utmost importance.

When reviewing the VAT data of large companies, it is rather common to discover that different accounting systems and/or software modules are used side by side within the organisation, depending on the activity or business line.

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The European Commission is currently working on a standardised VAT return providing a simpler structure and uniform information and deadlines for VAT declarations across the European Union

Whether this is because a specific system or module is more appropriate for the needs of a particular department or is used for historical reasons (e.g. it was the accounting system used prior to an acquisition), it is imperative that the different systems and modules can communicate in order to avoid having to gather the requested VAT data manually. Ideally, the VAT data should be entered into the system generating the VAT return automatically. It is therefore crucial to have a perfect understanding of how such a transfer will take place.

Another point to keep in mind is that the initial entry of VAT data into an ERP system must be reviewed and updated regularly. VAT rules are very fast moving, especially so in recent years.

The so-called VAT package has introduced new rules and new VAT related compliance obligations have been coming into force since 2010, with more rules to be put into place before 2015. These new rules have impacted, among other things, the place of supply of services for VAT purposes, meaning that a service that was subject to Luxembourg VAT at 15% in 2009 became subject to the reverse charge mechanism in the country where the recipient is located in 2010. Should a company neglect to update its VAT codes in time, retrospective amendment of the VAT returns and European sales listings for the years in question could be an expensive process.

VAT data management should not be taken lightly. This should be a serious process subject to regular updates. Experience shows that implementing a strategic combination of process monitoring and software automation is the recipe for effective VAT data management. This may require considerable effort. However, given that the authorities are tending towards increased information provision requirements for audits (the OECD's Standard Audit File for Tax has been implemented in Luxembourg, for example), an efficient VAT data management system appears to be a 'must have'.

# The Cloud revolution within HRIS

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In recent years, cloud computing and the related ‘Software as a Service’ (SaaS) products have experienced unprecedented growth.

In the field of Human Resources, although Enterprise Resource Planning (ERP) systems still have a dominant market position, revenue growth of SaaS solutions demonstrates that this trend is reversing. HR SaaS solutions have become an integral part of the HR applications landscape; they cover both core HR functional areas and more specialised ones such as recruitment or talent management. The emergence of new players (such as Workday) and recent takeovers (Taleo by Oracle and SuccessFactors by SAP) confirm that SaaS is not merely a fad but a deep-rooted trend.

#### HR SaaS model: the reasons behind its success

To explain its success, customers often cite the benefits generated by these new solutions and the context in which they operate.

#### Greatly reduced costs

Due to an environment in which CHROs are under constant pressure to reduce costs, the financial aspect is obviously becoming a major criteria in selecting an HR solution or associated architecture.

In this context, setting up a cloud solution could generate a reduction in the Total Cost of Ownership (TCO) of up to 35%.

This cost saving would be based on three main levers:

- **Reduction of hardware cost:** as the solution is hosted remotely (in the cloud), there is no need to invest in infrastructure: no server and no software to install.
- **Reduction and control of maintenance costs:** SaaS solutions are hosted remotely by the publisher and maintenance activities and troubleshooting errors are incorporated into the price paid to the publisher.
- **Reduction of capital employed:** the cost of using a SaaS solution becomes a controlled Operating Expense (OPEX) rather than a Capital Expenditure (CAPEX) associated with a physical hosting solution on site.

CIOs are also impacted: mobilising IT resources on HRIS is often carried out at the expense of the company’s core business. With constantly rising pressure on their level of service and on their costs, they are increasingly opting for cloud solutions when it comes to their HRIS.



### **A service model that responds to economical evolutions**

The cloud offers significant opportunities to develop information systems into more agile architectures, allowing faster responses to market trends. It also guarantees significant flexibility for organisations with variable workloads, for which the ability to add or remove capacity becomes a requirement.

Among the many benefits of the structuring principle of SaaS solutions are:

- A single environment shared by all customers
- Updates and version changes made directly by the publisher with no action required from the user

Users no longer have to embark on time-consuming and expensive projects to equip themselves with the latest version of a product, thereby significantly reducing the total cost of HRIS.

### **Fast implementation**

On average, implementing cloud solutions takes much less time than implementing an ERP solution, mostly due to the absence of infrastructure and specific settings. The time saved is even greater when projects incorporate phases of international expansion.

### **A powerful decision-making tool**

The reporting capabilities of ERP are traditionally quite limited and difficult to implement. Many SaaS, including Workday and Oracle Fusion systems, offer features to assist decision-making through integrated graphical reporting, key indicators and dashboards that can be custom built by the user.

### **SaaS solutions as a means to transforming the HR function**

According to a recent study by Deloitte, 84% of organisations surveyed were planning (or had started) to transform their HR function, the majority with the objective of reducing costs (85%) and improving the efficiency of the HR function (75%).

SaaS solutions are increasingly used as a transformation accelerator, as they allow a clear and quickly achievable return on investment, improving the quality and efficiency of services at reduced and controlled costs.

Beyond the ability to work more quickly, efficiently and economically, these technologies provide HR organisations with entirely new capabilities to better support HR management and decision-making.

## Maximising the benefits of cloud HR systems

What are the benefits  
for the HR function?



### A new design focused on the user

A recent study pointed out that LinkedIn offered more information about an employee than any HR Information System available to CHROs.

This study demonstrates the inefficiencies of the HRIS transaction-based profile as compared to the new type of system built around the employee and promoting the exchange of information.



### Strengthened talent management

Having the employee at the heart of HRIS is also imperative for talent management. With men and women now being recognised as the only real contributors to competitiveness, HR must have a clear picture of their development potential and aspirations to better identify sources of recruitment, development policies and HR-related services.



### The establishment of global models

In addition to the benefits for the organisation, CHROs also recognise the benefits for their own tasks. Today, they want to promote global human models through standard processes. However, this approach is also the one that guides SaaS solutions, with the promise of flexibility and integration of local features (especially in data strongly influenced by national cultures) still kept.



### A new dimension for the HR business partner role

One of the other main contributions of the SaaS model to the HR function is its reporting capability with predictive analytics. A user of a SaaS HR solution with the appropriate security rights is able to produce reports without anybody else's input, with the advantage that information is available immediately. This new responsibility, however, can be counterproductive in a business that would not have guided its employees. However, the business partner dimension of the HR function can be enhanced through the ability to configure its status and some of their authorisations directly in the tool.



What are the benefits for the user?



#### Cutting-edge tools

The sensitivity of users vis-à-vis HRIS seems to lie in the ability of the latter to remain in line with the times. Current trends are, among others: mobility, collaboration and network strength, control of its own responsibilities and well-being.



#### Career monitoring

At last, SaaS solutions seem to be combining the best of social networks and professional networks in one HRIS. Mastering the tool, browsing freely and getting the best of it is a huge step towards controlling one's own career within the company.



#### Mobility and virtual interaction

Mobility is reflected in the smartphone versions of HRIS solutions, especially with the inclusion of the self-service (employee or manager) sections. From home and without being connected to any local professional network, the employee can continue to control their personal data, declare their leave and take any action required in a HR workflow validation.

SaaS solutions enable one-click access to members of the team to which the employee belongs, organisations and their members, the public profile of the manager, etc. Like any professional network, members of the organisation can submit feedback on the profile of an employee and contribute to a 360° performance evaluation.

#### In summary

The cloud contributions in the field of Human Resources significantly change the way HRIS is perceived. This represents an opportunity in terms of quality of service, process streamlining and cost reduction.

Businesses, if they have not already done so, must examine the maturity of their HRIS and assess whether it would be beneficial to migrate all or part of their HRIS to the cloud.

Given the impact for the HR business, CIOs and CHROs need to assess the influence in terms of organisation and consider the architecture-related implications of the project.



# Digitisation of documents and legal archiving

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## The shift from physical documents to digital documents, otherwise known as dematerialisation.

Information is the memory of a company. Digital documents are taking over from paper documents, but some questions need to be answered before shifting completely from one to the other.

First you have to digitise your data: transfer the data from physical form to digital form. However, depending on how the electronic data will be used and what you will do with the existing printed documents, the type of technical solution you choose will differ.

Before deciding on a solution, some preliminary questions must be answered:

- Will the information be used for everyday purposes? (i.e. do I need data to be organised?)
- Should the information be protected? (i.e. do I need to restrict access to the data to certain users?)
- Will I destroy the original printed version? (i.e. do I need the document to have legal value?)

The answers to these questions determine what features are required and thus will guide the company in its choice of technical solution. Below you will find three possibilities:

	Document Management System (DMS)	Data Vaulting	Legal Archiving or e-Archiving
<b>Definition</b>	Set of tools and techniques to acquire, order, manage, store and publish electronic documents inside an organisation.	Digital equivalent to a physical safe.	Set of tools and techniques to identify, select, order and store electronic documents on a secure system in the long term.  Legal archiving goes one step further than e-Archiving as it involves giving a legal value to the archive.
<b>Key features</b>	<ul style="list-style-type: none"> <li>• Updates possible on multiple versions</li> <li>• Document destruction possible by employees</li> <li>• Use for day-to-day work</li> <li>• May include managing the document's disposal</li> <li>• May be structured</li> </ul>	<ul style="list-style-type: none"> <li>• Virtual space for storing and archiving</li> <li>• Secured logically and physically)</li> <li>• Impregnable</li> <li>• Documents returned to the owner without modification</li> </ul>	<ul style="list-style-type: none"> <li>• It is not possible to modify documents</li> <li>• Destruction is forbidden, except under strict conditions</li> <li>• Includes managing the document's disposal</li> <li>• Legal archiving (in addition to e-Archiving):                             <ul style="list-style-type: none"> <li>- Electronic signature of the document</li> <li>- Maintain integrity of the document over time</li> </ul> </li> </ul>

In the rest of this article, we will expand further on legal archiving. The objective is to highlight points for analysis when this solution is envisaged.

### e-Archiving and legal archiving: two sides of the same coin

#### The planned change in the legal framework

A legal framework concerning electronic archiving already exists in Luxembourg. However, this framework does not provide a sufficiently solid legal guarantee regarding the destruction of an original document that has already been digitised. To address this issue, in 2008 and 2009, the CSSF and the ABBL recommended that original documents not be destroyed. To overcome this limitation, a team of experts was gathered to design a new legal framework based on a new law on electronic archiving—an update of other impacted laws (Civil Code, Commercial Code, Financial Sector Law) and of the related Grand Ducal Regulation (GDR).

The proposed legal framework puts forward several major considerations:

- **Creation of the Dematerialisation and Conservation Service Provider status (defined as 'PSDC' in the draft law):** the objective is to regulate the activity of digitisation and archiving and thus build the trust of those companies receiving services, as well as the trust of judges, ministries, administrations and courts. PSDCs will be monitored by ILNAS through a formal accreditation scheme. An organisation can choose to become accredited for digitisation and/or archiving. It should be noted that a specific PFS status will be created for PSDCs serving the financial sector.
- **Reversal of the burden of proof:** in the event that a faithful copy of the original document is produced and archived by a PSDC under the conditions set forth in the GDR, it will be the duty of the plaintiff to prove that the copy is not a faithful or sustainable reproduction of the original document.
- **Technical and organisational requirements:** the GDR, and more specifically the accreditation scheme, will set precise technical requirements, organisational constraints and implementation conditions.

As of today, the draft bill, draft updates to impacted laws, and draft updates to the GDR have been submitted to the Chamber of Deputies. The draft bill has received comments from the Chamber of Commerce, the Chamber of Trades and the Council of State. Large parts of the supervision scheme have also been published by ILNAS. The new government has given high priority to this law and it is expected to be adopted by the end of 2014.



<sup>1</sup> ISO/IEC 27001:2005, part of the growing ISO/IEC 27000 series of standards, is an information security management system (ISMS) standard published in October 2005 by the International Organisation for Standardisation (ISO) and the International Electrotechnical Commission (IEC). As of October 2013, a new version has been published: ISO/IEC 27001:2013.

<sup>2</sup> ISO/IEC 27002 provides best practice recommendations on information security management for use by those responsible for initiating, implementing or maintaining information security management systems (ISMS).

### Technical regulation requirements and measures

As part of the supervision scheme, technical requirements were published by ILNAS in June 2012. The framework is based on three layers. The first layer is the foundation and applies ISO/IEC 27001<sup>1</sup> and 27002<sup>2</sup>. The second layer provides more detail on a number of ISO/IEC 27002 controls and tailors them to reflect digitisation/archiving activities. The third layer consists of more measures and additional controls on top of ISO/IEC 27002 and is specific to digitisation/archiving. The controls and measures in layer three include information on digitisation/archiving policies and technical requirements for the systems supporting digitisation/archiving as well as their usage. Overall, the latter provides a more detailed understanding of what the digitisation/archiving software should and should not do. The accreditation scheme also includes documents relating to the supervision of PSDCs and audit guidelines.

### What if digitisation and archiving services are provided to financial institutions?

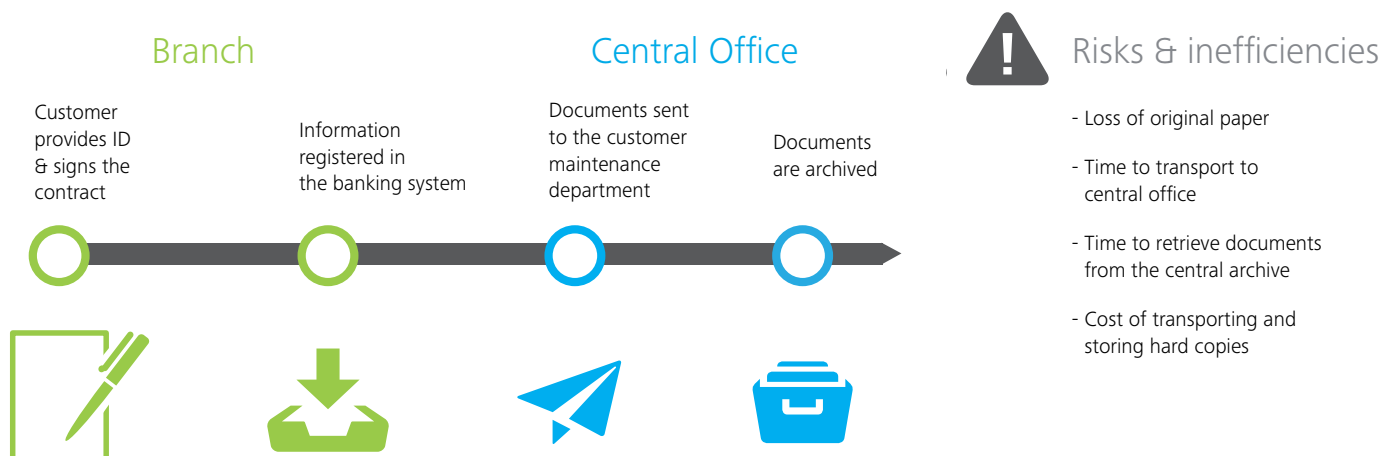
Whenever digitisation/archiving services are provided to financial institutions, all PSDCs are also required to obtain PFS status. Two new Auxiliary PFS statuses (Articles 29-5 and 29-6) are expected to be added to the law of 5 April 1993 on the financial sector. Conditions set forth for the PFS status include a share capital forecasted at EUR 50,000 for digitisation service providers (PFS/PSDC-D) and at EUR 125,000 for archiving service providers (PFS/PSDC-C).

Consequently, the PSDC will be supervised by both ILNAS, for its PSDC status, and by the CSSF, for its PFS status. As of yet, other than those circulars applicable to Auxiliary PFS (including CSSF Circular 12/544 concerning the risk analysis and descriptive reports), no regulation/circulars specific to PFS/PSDCs have been published by the CSSF.

### Opportunities to move towards digitisation and e-Archiving

Many organisations are already digitising their documents but have yet to make the decision to destroy their hard copies. While there is a real business for digitising documents, there is still a need for a greater shift in the general mind-set of both individuals and businesses for destroying or archiving documents. The overall objective of the planned change in the legal framework is to increase trust in companies specialised in digitisation and archiving. This trust will be achieved through greater supervision of digitisation/archiving companies, by guaranteeing the financial stability of the service provider, as well as through process transparency and documentation at the service provider, archiving sustainability and the obligation for document restoration. A good example is the account opening process in banks. Opening an account for a new customer usually consists of the following steps: the new customer provides specific documents to identify himself or herself to the banker at the branch (e.g. ID, salary slip) and then signs a contract. The information is then entered in the banking system. The documents are sent to the customer maintenance department in the central office to confirm the opening of the new account. Finally the documents are archived in a central location, usually somewhere other than the central office.

### Example of a simplified account opening process based on hard copies



When using hard copies with a legal value, this process currently presents three major drawbacks: operational risk (i.e. loss of original paper), inefficiency (i.e. time to transport documents to the central office, time to retrieve documents from the central archive) and cost of transporting and storing hard copies (i.e. renting buildings for paper archives).

Digitising documents from the branches will provide a solution to these three drawbacks. It would optimise the process and thus reduce the time it takes to open an account, minimise the overall operational risk and reduce or even eliminate the cost of transport and storage. Indeed, major banks have already set up, or are in the process of setting up, 'SCAN TO PROCESS'. Digitisation of electronic archives, which means going one step further—'SCAN TO ARCHIVE'—will only completely do away with the transport/storage of the original paper if the original document can be destroyed.

#### What is the business case for archiving after digitising?

When it comes to taking the plunge of archiving and thus initiating an electronic archiving project, clear objectives must be defined by carrying out a thorough analysis. The questions below will guide the analysis and support the organisation in more clearly defining the scope, objective and expected return on investment:

- **Are we going to destroy the physical document?**  
This question will help to determine the cost-saving potential of the project.
- **For legal archives, are we really going to destroy the original document?**  
This question will raise the issue of whether or not PSDC accreditation needs to be obtained.
- **For which documents are we required to ensure reversal of the burden of proof?**  
This question will determine whether PSDC accreditation is required.
- **In which jurisdictions outside of Luxembourg will the electronic archive be accepted?**  
This question will help determine whether PSDC accreditation will cover the whole geographical scope of the legal archives.

- **What is the cost of storing paper versus the cost of the IT infrastructure and the cost of ensuring integrity and sustainability of the electronic archive?**

This question will help to determine the return on investment of electronic archives.

- **For legal archives, what is the cost of storing paper versus the cost of the IT infrastructure, the cost of ensuring integrity and sustainability of the electronic archive and the cost of maintaining a PSDC accreditation, including audits?**

This question will help to determine the return on investment of the legal archive.

- **Are we implementing this for new documents or also for existing documents?**

This question will raise the issue of whether an additional one-off and time-consuming exercise, i.e. digitising existing documents, is required.

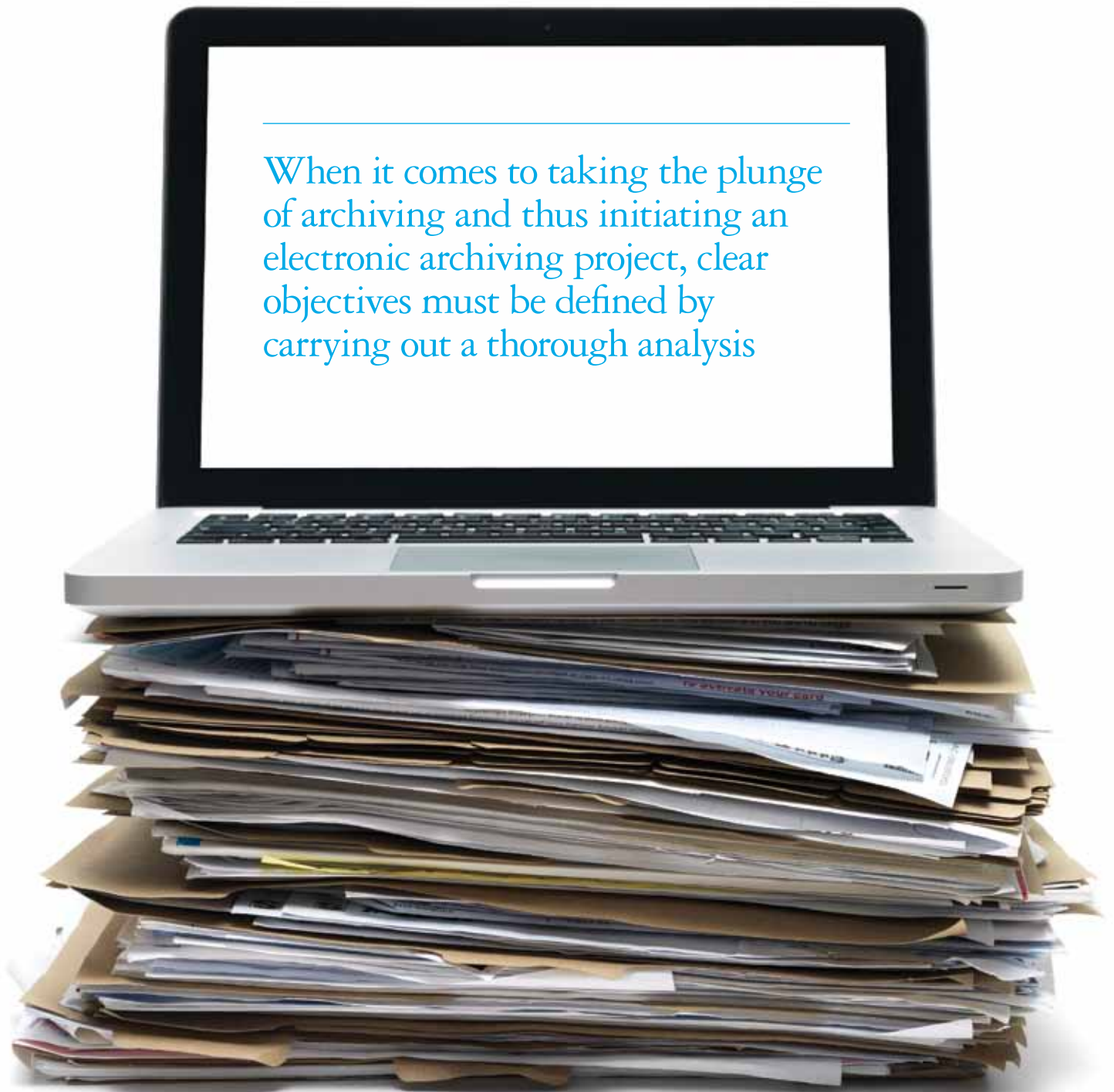
If legal archiving is an absolute requirement under the scope of the project, obtaining PSDC accreditation is not the only option available. There are various sourcing models that can be adopted for legal archives:

- The first alternative is to insource the process and implies obtaining PSDC accreditation.
- The second alternative is to outsource the digitisation part or archiving part of the process by using a PSDC-D for digitisation or a PSDC-C for archiving. This model implies obtaining PSDC accreditation for the part of the process insourced. In relation to the question of digitising existing documents, the process could be outsourced for existing documents and insourced for new documents.
- The third alternative involves fully outsourcing the process to digitisation and archiving service providers with PSDC accreditation.

Overall, in the first and second alternative, digitisation and archiving service providers will benefit from pooling costs.

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When it comes to taking the plunge of archiving and thus initiating an electronic archiving project, clear objectives must be defined by carrying out a thorough analysis



# The need for multi-level healthcare governance

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Together with education and security, health is a major issue for citizens today. Knowing that you are in good health, but also that you will be treated rapidly and receive a high standard of care has been a major concern for Western countries and their citizens for more than 20 years.

To demonstrate that this concern has genuinely been taken on board by governments, we only have to look at spending in OECD countries between 1990 and 2010: over this period, health spending per capita increased by more than 70% in real terms<sup>1</sup>.

However, it took a long time for the governance<sup>2</sup> of healthcare systems to be examined in terms of efficiency (the cost-benefit ratio). The ultimate aim was to improve the health of the population, and this can be seen in the increase in life expectancy<sup>3</sup> and fall in mortality rates for

certain diseases, such as cancer<sup>4</sup>. Nonetheless, some years ago now, primarily in the wake of the economic crisis, governments began slashing their healthcare budgets. For example, within the OECD, while health spending increased by more than 4% per year on average between 2000 and 2009, the equivalent figure for 2009-2011 was just 0.2%<sup>5</sup> (figures 1, 2 and 3 on page 88). The crisis has had a major impact on this area of spending, which in 2011 represented almost 9.3% of GDP on average in OECD countries<sup>6</sup>.

<sup>1</sup> *Healthcare systems: getting more value for money*, OECD (2010)

<sup>2</sup> *Governance refers to 'all processes of governing, whether undertaken by a government, market, or network, whether over a family, tribe, formal or informal organization, or territory, and whether through laws, norms, power, or language.'* (Bevir, Mark, 2013. *Governance: A very short introduction*. Oxford, UK: Oxford University Press).

<sup>3</sup> *Increase in life expectancy of more than 10 years between 1970 and 2011 in the OECD ('Health at a Glance', OECD, 2013)*

<sup>4</sup> *Cancer-related deaths fell by 14% between 1990 and 2011 ('Health at a Glance', OECD, 2013)*

<sup>5</sup> *'Health at a Glance', OECD (2013)*

<sup>6</sup> *Op. cit., OECD (2010)*



However, in the current wave of austerity, it is clear that today's governments are tending to focus the debate on the type of system (market-based or centralised), reflecting more on ideological differences (in terms of liberalism and socialism), when they should instead be focusing more on how their systems are managed. According to the OECD<sup>7</sup>, better management at national level could reduce costs by around 2% of GDP on average in OECD countries by 2017, without diminishing the quality of care available<sup>8</sup>.

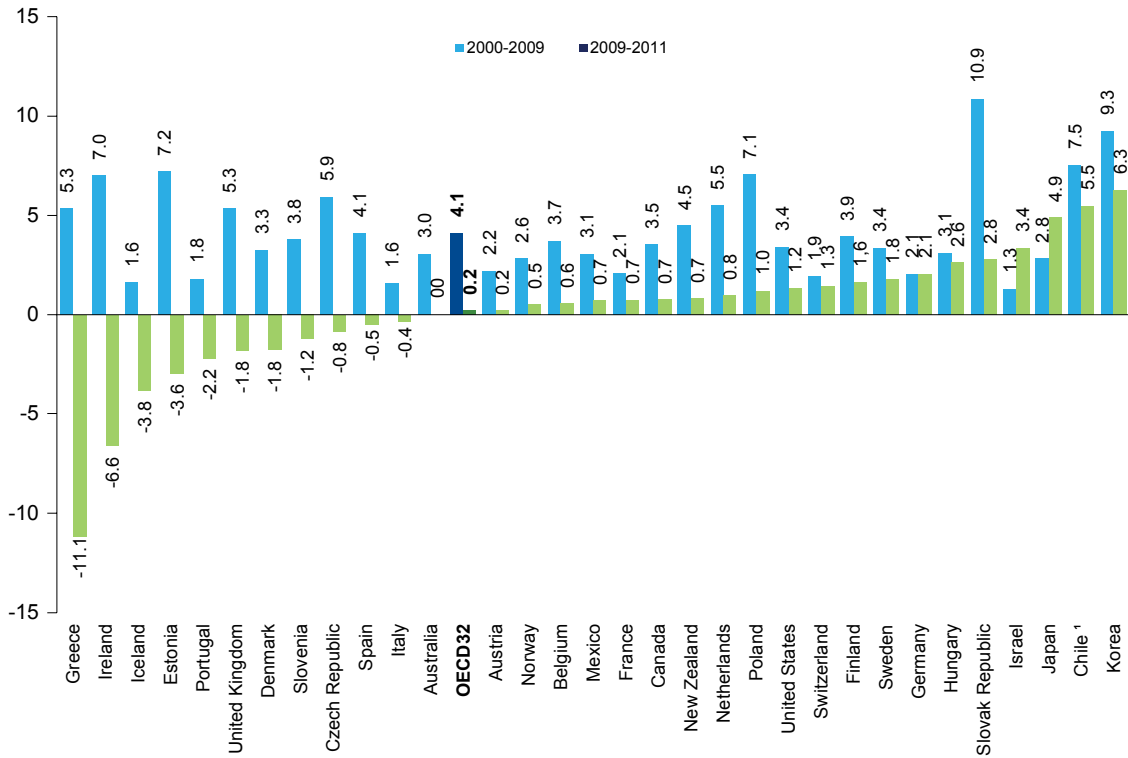
<sup>7</sup> *Ibid.*  
<sup>8</sup> *Ibid.*

Moreover, thinking in terms of management rather than the system would give countries greater flexibility to meet new challenges such as the ageing population, the growing expectations of the public and the migration of patients and healthcare professionals, as well as health tourism.

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Today, countries have a tendency to choose their system based on local, regional and national factors, as well as ideology

Figure 1: annual average growth rate in per capita health expenditure, real terms, 2000 to 2011 (or nearest year)



Source: OECD Health Statistics 2013, <http://dx.doi.org/10.1787/health-data-en>; WHO Global Health Expenditure Database.

Figure 2: health expenditure as a share of GDP, 2000-2011, selected G7 countries

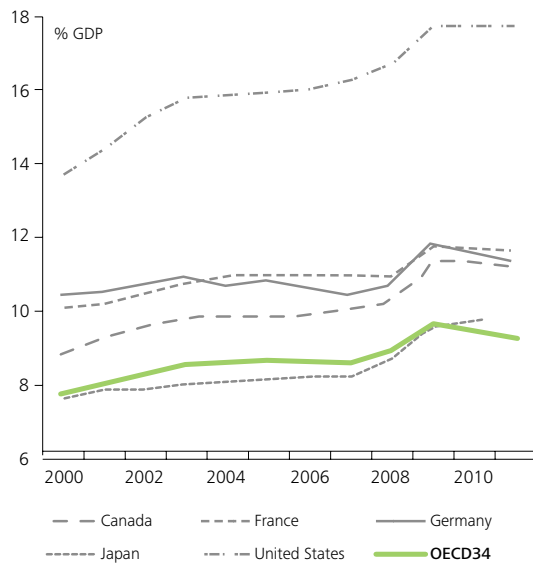
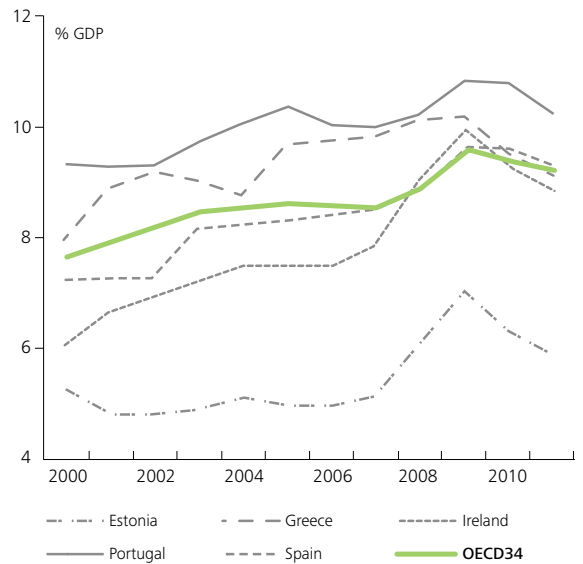


Figure 3: health expenditure as a share of GDP, 2000-2011, selected European countries



Source: OECD Health Statistics 2013, <http://dx.doi.org/10.1787/health-data-en>.

Source: OECD Health Statistics 2013, <http://dx.doi.org/10.1787/health-data-en>.



In other words, every system has its limits and is strongly bound by national constraints (the political system, level of affluence, etc.). However, any system can be made more efficient without cutting services and reducing the quality of care by rethinking its management at every level. In fact, management does not stop at national level but should be implemented at all levels:

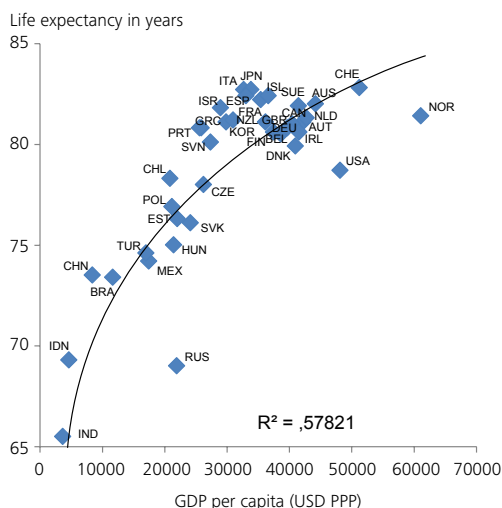
- **Meta:** management of the environment and the entire system of hospitals and clinics by government institutions and regulatory bodies
- **Macro:** management of hospitals and clinics and the various specialisations by a management committee/administrative board
- **Micro:** management of work devoted to the patient, and management of requirements and specific needs by a management team

**Meta governance must focus on the consistency of its actions**

As set out below, there are many ways in which healthcare systems could be reformed and enhanced. Today, countries have a tendency to choose their system based on local, regional and national factors, as well as ideology. What we tend to forget is that each country is different and does not have access to the same resources. As a result, efficiency gains vary considerably between countries. Nonetheless, each country can make its system more efficient by improving management and thus achieve better outcomes for the amount they spend (figures 4 and 5). Ultimately, the selected system can only have a limited impact on efficiency.

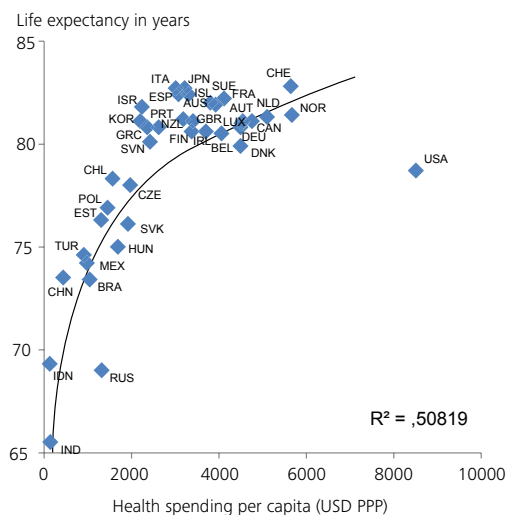
Nonetheless, some years ago now, primarily in the wake of the economic crisis, governments began slashing their healthcare budgets

Figure 4: life expectancy at birth per capita, 2011 (or nearest year)



Source: OECD Health Statistics 2013, <http://dx.doi.org/10.1787/health-data-en>; World Bank for non-OECD countries.

Figure 5: life expectancy at birth and health spending per capita, 2011 (or nearest year)

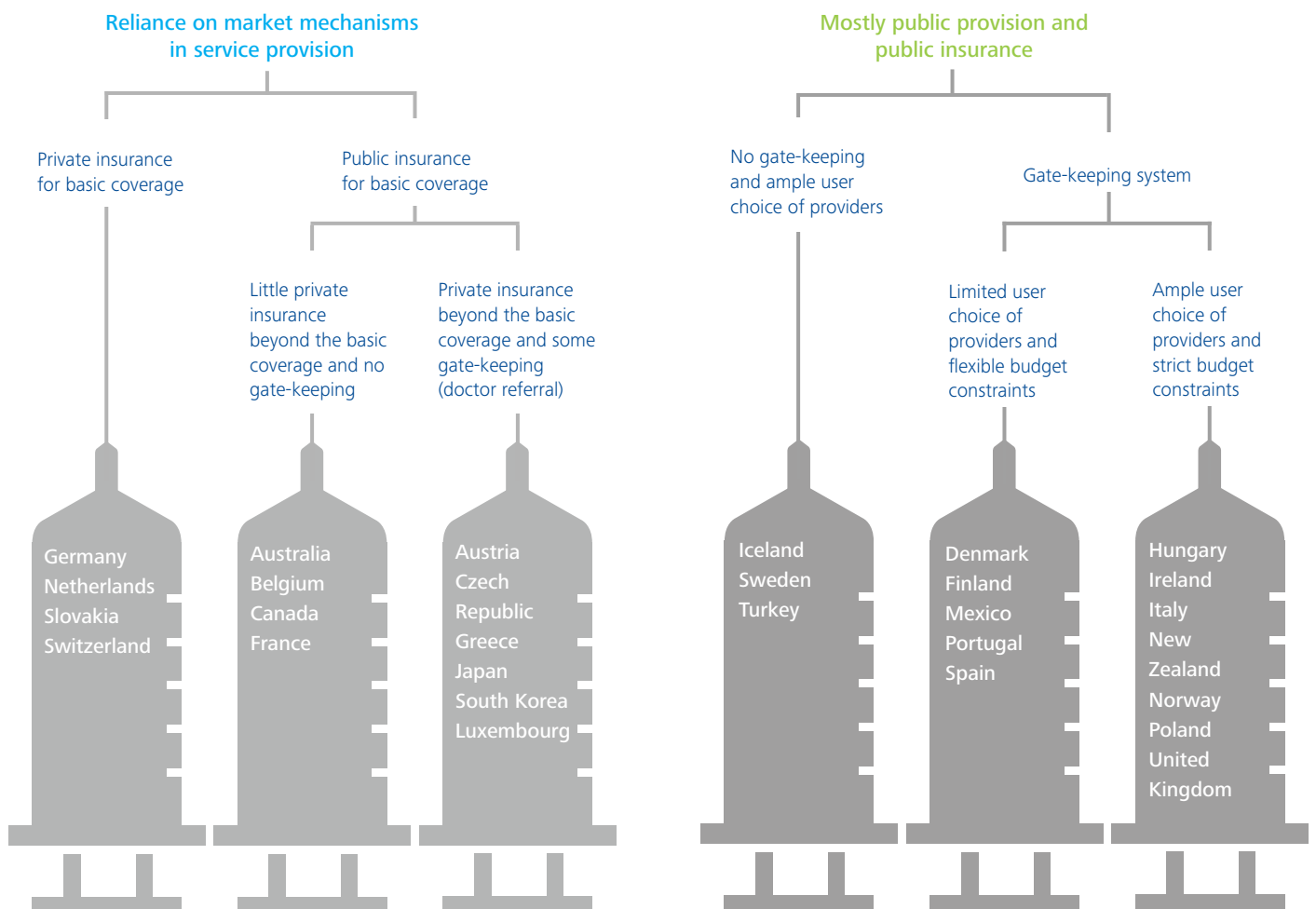


Source: OECD Health Statistics 2013, <http://dx.doi.org/10.1787/health-data-en>; World Bank for non-OECD countries.

What we tend to forget is that each country is different and does not have access to the same resources. As a result, efficiency gains vary considerably between countries

Thus, government bodies, institutions and interest groups should not seek to put in place a perfect system or compare their systems with those of countries that have similar institutions or ideology<sup>9</sup> (figure 6), but instead they should target consistency between the operational parameters within their system and adopt the management practices of countries of a similar size, with similar resources, etc. Ultimately, it is not a question of knowing how to charge for health services (per procedure or per activity), or spending hours considering which system is best, or even wondering whether or not centralising healthcare services is more efficient.

Figure 6: groups of countries sharing broadly similar institutions



Source: 'Healthcare systems: getting more value for money', OECD (2010)



Instead, governments and other national regulatory and management bodies should think in terms of meta management: at this level, it is important to look beyond the organisation and to be clear on the aims and *raison d'être* of the system, without entering into an ideological debate. There is a need to define openly and clearly what is expected in operational terms, while at the same time knowing that management will do most of the work. This means putting in place consistent operations that achieve rapid, positive and tangible results.

However, it will be by stimulating debate and raising awareness of this fact in the political, social and economic spheres at national level that expectations will be turned into real savings. With the aim of raising awareness, here is a list of the main discussion points that the key players must dare to talk about openly in order to ensure consistency in their actions:

- **Constantly rethinking the service model.** Establishing and regularly re-assessing the priorities for services that are reimbursed through regular reviews will promote increased awareness of technological advances in healthcare and research.
- **Focusing on the environment and not on the entity.** The responsibilities of national regulatory bodies and government regulators must be clearly separated from those of the management bodies of hospitals/clinics. By defining the chain of responsibility more clearly and implementing more transparent legislation on expectations for management of hospitals/clinics, the system will avoid duplication and conflicts of interest.
- **Controlling the costs of infrastructure and medical expertise.** One of the main causes of rising costs stems from the poor use of new technologies, rather than their purchase in the first place. At the meta management level, it is important to rationalise and regulate supply on a geographical basis, to ensure that there is no unnecessary duplication of infrastructure or medical expertise.
- **Creating genuine international competition.** Prioritising the rights of patients and offering them the choice of having their treatment in another country will put additional pressure on care quality and transparency. Hospital management will be forced to recognise and accept criticism from the consumers of healthcare if they wish to compete.
- **Promoting the use of new technologies.** Information and communications technologies can reduce costs. For example, knee surgery used to mean patients missing work for several weeks or months, but thanks to technology, this has been reduced to no more than a week or two. It is therefore necessary for meta management to support its members in working with modern facilities.
- **Educating healthcare consumers.** The system's management should also seek to boost the critical faculties of the main reason for the rise in costs: the user. The use of campaigns and comparative tools enables citizens to be more critical and rational about their needs and the treatments offered to them.

<sup>9</sup> As shown, for example, in figures 4 and 5, and as underlined by the OECD (*op. cit.*), efficiency varies more within groups of countries that have similar institutions than between groups of countries that are comparable in terms of size or resources, etc.

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## In other words, every system has its limits and is strongly bound by national constraints (the political system, level of affluence, etc.)

### Macro and micro governance must rethink their processes

Although it is possible to separate these two levels, we prefer to combine them, since they do not operate outside the organisation but through it. However, it is worth pointing out their differences.

At the macro or micro level, it is no longer an issue of debating the type of system or discussing the organisation of the system's operation, but of finding an internal operating model that delivers services as efficiently as possible and provides patients with the quality of healthcare they expect at a controlled cost. In other words, the challenge for hospitals at the macro and micro level is to rethink their processes from design through to application, rather than introducing or delivering new products, services or solutions. It is clear that some see these ideas as a form of standardisation of processes and a de facto loss of quality. Nonetheless, it is worth considering the case of Dr. Devi Shetty, who can now offer an operation that costs USD 106,385 in the United States<sup>10</sup> for USD 1,583 in India, after rethinking his processes.

Put another way, the responsibility of governance at a hospital's macro level is to make sure that things are done through others (groups, people, structures) in a forward-looking way, whereas at the micro level they should be done while looking at the present. In both cases, the focus should be on the continuity of the various actions in order to ensure a certain consistency in the way they are carried out—only the objective should be different.

The focus in the first case should be on the consistency of all the processes and related products, services or solutions provided to the patient, while in the second, it should be on the direct delivery of products, services or solutions to the patient.

So, to promote critical thinking and to challenge the status quo, we invite the decision-makers and managers at these levels, as well as all other healthcare professionals, to consider, with an open mind, these discussion points that will enable them to rethink their internal processes:

- **Evaluating their market positioning on a regular basis.** Hospitals and clinics should rethink their core business in terms of specialisations. Their reputation will be built on specialisation in particular areas (e.g. rehabilitation, cardiac surgery, etc.), in which all healthcare professionals (doctors, nurses and other clinical staff) play a complementary and essential role in the quality of the service delivered to patients. It is the interaction between the different healthcare professionals who have direct contact with the patient that creates value added rather than a single aspect of the treatment package.
- **Avoiding the categorisation of their human resources.** In addition to the above, the management should rethink their human resources in terms of skills and the complementary aspects of the different care providers. This is because medicine is no longer the core business of hospitals and clinics. Patients need nursing care and other types of treatment to get better. Hospitals and clinics will therefore have to promote their real core business by managing their activities and roles in a holistic way, without favouritism/protectionism, rather than by separating activities and roles.

<sup>10</sup> 'Heart Surgery in India for \$1,583 Costs \$106,385 in U.S.' by Ketaki Gokhale for Bloomberg.net (28 July 2013)



- **Reviewing the roles and responsibilities of each healthcare professional.** Looking at all times through the prism of rethinking processes, the governing boards of hospitals and clinics have to accept that although medicine (excluding diagnostics) is a technical exercise requiring a high degree of precision, it may, with the right training, be delegated to nurses or other clinical staff. Methods of operation and delegation will therefore have to be reconsidered.
- **Rethinking the governing board.** Today, most hospitals and clinics are run by a three-person management team (directors of medicine, nursing and administration). However, given the changes made to healthcare systems in recent years, hospitals have changed considerably since they were first established. Managing a hospital is now a full-time job. Given government constraints and increasingly demanding patients, hospital governing boards must have professionals in place who not only know the industry, but can rethink hospital organisation in terms of efficiency. This means that professional medical training, whether as a doctor, nurse or physiotherapist, is no longer sufficient. Members of the governing board require training in management and administration.

#### Healthcare governance: case-by-case review

It is not necessary for countries to compare systems based on the same ideology; instead, in a meta approach, governments should aim to achieve the same level of efficiency as the best performers without actually copying them. In other words, radical reforms are not required. It would probably be better and more effective for each country to adopt the best practices implemented by comparable countries in terms of resources (target group) and not to adopt practices implemented by countries with the same ideology.

Thus, efficiency stems not from the system itself but from multi-level management (meta, macro and micro), through the consistency of operations arising from decisions between the levels that can really impact outcomes. Governments must therefore take the lead and be bold in tackling these difficult issues, while hospital management will have to accept that it needs to rethink its roles and functions. However, the implementation of multi-level governance must and should be carried out following a review of current models and the overhaul of operating principles on a case-by-case basis. And finally, it is worth restating that the aim is not to introduce new products, services or solutions, but to re-engineer processes: the backbone of the health system.



# Governance of large scale EU projects

## Trends, challenges and solutions

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Governance of the EU and its institutions is one of the single most debated topics within Europe, keeping many academics and think-tanks actively at work. However, given that the EU is the largest and most prosperous trading bloc in the world, the attention is warranted. Whether it be the acceptance or establishment of new members, directives, new institutions, political decisions at EU level, typically incur some level of practical integration. This can range in complexity from establishing a new office (e.g. a new agency) to the creation of pan-EU networks to be integrated with existing member state infrastructure (such as those in use for taxation under the European Commission's DG TAXUD). What are the trends for the future and what do they mean for IT governance?

### Megatrends in the EU

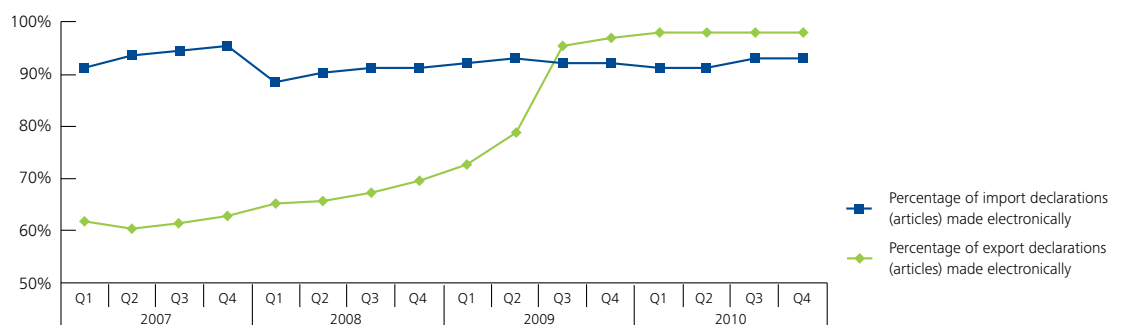
According to the Copenhagen Institute for Future Studies<sup>1</sup>, of which Deloitte is a member, megatrends are great forces in societal development that will affect all areas—state, market and civil society—for many years to come. Globalisation is one such megatrend, with EU integration possibly the most visible example of globalisation occurring in a regional context. EU member states are committed not just to sharing and centralising authority in certain areas, but also to actively cooperating with the subsequent framework. However, as the EU system evolves, so does the underpinning electronic infrastructure which supports it.

A good example of this has been the development of the EU's statistical gathering system, under the supervision of Eurostat. Prior to the 1990s, EU statistical gathering was concentrated in the two areas where the EEC had 'genuine Commission policies'<sup>2</sup>: agriculture and external trade. However, the situation changed as more EU policies became grounded directly in statistics, such as the convergence criteria for EMU of the Maastricht Treaty. This development greatly contributed to the general expansion of statistical legislation, resulting in the investment of statistical systems<sup>3</sup>.

A second megatrend is the general acceleration and sophistication of technological development within our society. Not only is the EU faced with integrating member state systems, but it must also respond to a societal pressure to make information sharing more available through a wider range of channels. The Commission has been successful in many cases, with major achievements in a number of tax and custom IT platforms introduced by DG TAXUD. From 2008 to 2011, the rate of electronic input increased mainly for export, due to the deployment of the trans-European Export Control System (ECS) which involved the automation of export in all member states since the beginning of 2008<sup>4</sup>.

However, such initiatives do not come cheap. The IT investments carried out under DG TAXUD cost EU member states €320 million during 2008, 2009 and 2010<sup>5</sup>.

Figure 1: development rate of electronic input—normal and simplified procedures together (27 member states)



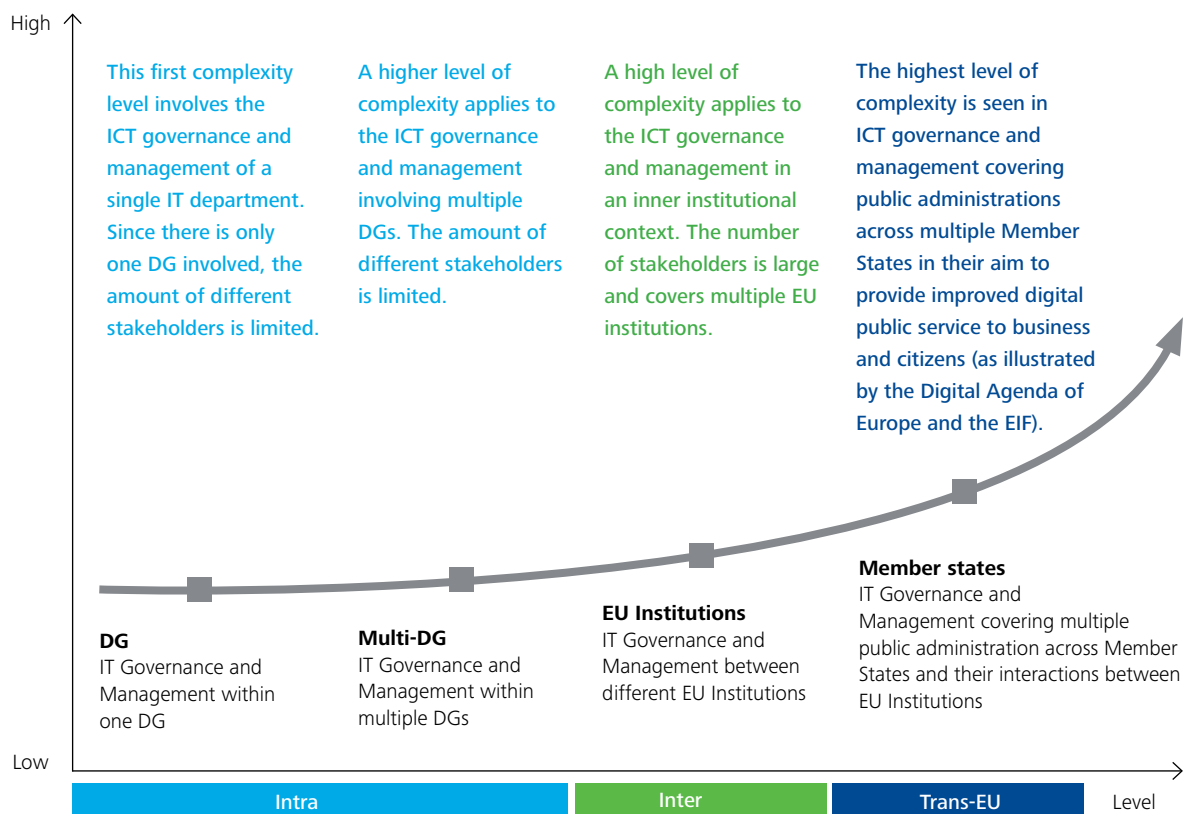
1 Copenhagen Institute for Future Studies, 'Why Mega Trends Matter?' Futureorientation 5/2006 See: <http://www.cifs.dk/scripts/artikel.asp?id=1469>. The Institute listed 10 megatrends, being: 1. Ageing, 2. Globalisation, 3. Technological development, 4. Prosperity, 5. Individualisation, 6. Commercialisation, 7. Health and environment, 8. Acceleration, 9. Network organising and 10. Urbanisation  
2 COM(2009) 404 final  
3 COM(2009) 404 final  
4 COM(2011) 922 final  
5 COM(2011) 922 final

### Challenges faced in large-scale EU projects

ICT governance and management in the European public sector faces one of the most demanding environments conceivable. The multiple dimensions (trans-European, intra- and inter-institutional) have different organisational structures and interactions with a growing level of complexity. This can range from one to multiple DGs to multiple institutions, trans-European organisations and interactions. The graph below illustrates that the level of complexity in the governance and management of ICT increases with each additional dimension.

This growing level of complexity is further influenced by a number of challenges and opportunities. These can be grouped into three main topics that have an impact on ICT governance and management in the public sector today:

- ICT leadership: how do you increase the efficiency and effectiveness of the ICT organisation as a whole to improve the quality of the services you provide?
- Interoperability: how do you reply to the ever growing need to ensure a seamless and secure data exchange across DGs, EU institutions and member states?
- Post-digital era: how do you cope with the emerging trends in technology that are reshaping the way public administrations in Europe are operating internally and providing services to citizens and businesses?







### ICT leadership

The most formidable and immediate challenge for the European Commission and public administrations at all levels is how to do more with less. With budgets remaining static or declining and personnel costs rising steadily along with the demand for services, EU institutions need to react promptly to operational efficiency opportunities. Over the past decades, the ability of IT to automate the delivery of services has been a powerful factor in achieving better performance at lower cost. But IT operations have often evolved in a fragmented manner that has created its own inefficiencies. With a multi-year plan to improve operations, IT has the opportunity to optimise its operations independent of the annual budget cycles. A common approach is to revise the current ICT governance structures and management processes in order to start operating in a more business-like way. To do so, IT organisations of the different DGs in the European Commission and other EU institutions should understand where opportunities exist to eliminate unnecessary expenses, streamline their operations (e.g. convergence of solutions) and provide improved services to their users using new delivery mechanisms (e.g. cloud computing). These three activities are fully in line with EU policies.

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According to the Copenhagen Institute for Future Studies, of which Deloitte is a member, megatrends are great forces in societal development that will affect all areas—state, market and civil society—for many years to come

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## The most formidable and immediate challenge for the European Commission and public administrations at all levels is how to do more with less

### Interoperability

Providing better services to citizens requires seamless and secure data exchange amongst EU institutions and public administrations in different member states. Appropriate ICT governance structures and management processes must have common technical standards to foster compatibility of IT systems and infrastructure on an inter- and intra-institutional level.

In a trans-European context, establishing interoperability amongst public administrations across member states is even more complex. This raises four challenges as defined by the European Interoperability Framework (EIF): legal, organisational, semantic and technical. While European Commission initiatives in these areas have led to many successes and lessons learned, they have also brought new challenges.

The IT operations of public administrations in a trans-European context often face conflicting demands, resulting in different objectives and priorities from the ones of other public administrations within other policy domains or member states. As a result, many programmes and IT systems that support these public administrations have become siloed.

In order to improve both the efficiency and the compatibility of IT operations of member states' public administrations, appropriate ICT governance mechanisms need to be defined to ensure that all stakeholders involved share the same vision, agree on common objectives and align priorities. To improve interoperability in Europe, processes to manage IT must be aligned across member states to enhance collaboration when setting up trans-European ICT solutions and to avoid redundancies in IT project and initiatives.

### Post-Digital Government

Over the past few years, five forces in technology have seen continuous development: social, mobile, cloud, analytics and cyber (security). These five forces have paved the way for several new trends in technology, which have not only changed people's personal lives but have also introduced shifts in the way today's private organisations do business. This evolution has led to an increasing demand for public administrations to apply these technology trends to deliver their services. When strategically combined, these trends help to boost productivity, enhance services to citizens and drive innovation. Together, they define the new 'Post-Digital Government Era'.

However, in order to obtain the numerous benefits that advancements in technology have to offer, the European Commission and public administrations at federal/ national, regional and local levels need to redefine their IT strategies, implement new governance structures and invest in new IT capabilities and skills. There is now an unprecedented opportunity for IT directors in the European Commission and public administrations across Europe to play a key role in transforming government to embrace the opportunities of the post-digital era.

To do this, they should have a clear understanding of their individual public administration's core mission and be able to offer both a compelling strategic vision of how technology can support that mission and a track record of measurable accomplishments that will inspire trust.



### Conclusion

The debate on good governance in the EU has traditionally focused on high level political governance rather than the 'nuts and bolts' of public administration. However, key megatrends are forcing the EU to develop a larger amount of IT platforms of increasing scale and sophistication in an environment which is already highly complex. In terms of IT governance, the European Commission can boast many successes in its response to these megatrends, but the pace and pressure involved is unlikely to decrease in the foreseeable future. Budget restrictions are more, rather than less, likely to fuel a desire for increased efficiency through technological development, while the EU still recognises five more candidate countries for membership of the Union. The quality of the governance of this ongoing integration will also need to improve if the EU and its members are to be able to deliver public services efficiently and effectively to its citizens.

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