VIEW POINT

# WALKING A REGULATORY TIGHTROPE

## Are Know Your Customer (KYC) utilities a viable solution?


### Abstract

Inundated with the ever-increasing customer information, compliance demands, many banks and financial institutions have begun subscribing to Know Your Customer (KYC) utilities. This paper examines the KYC utilities market and their effectiveness in addressing the cost, time, and effort challenges that the increasing volume and complexity of the KYC documentation process brings with it.


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## Get to know your customer. But why?

There's a pretty good reason to know your customer. The Know Your Customer (KYC) process allows banks and financial institutions to maintain detailed records of their customers and investors. This reinforced identity verification norm helps banks and financial institutions identify suspicious activities and prevent the circulation and laundering of dirty money. Consequently, by 2010, most countries had made KYC mandatory.

The KYC process begins with collecting basic identity information. Once the initial customer information is collected, due diligence kicks in. There are five broad KYC due diligence requirements for banks and financial institutions:

- **Minimum Due Diligence (MDD):** Done to fulfill basic KYC requirements encompassing the Customer Identification Program (CIP) by leveraging government authorization – whether the entity is regulated and/or listed on stock exchange.
- **Standard Due Diligence (SDD):** Covers CIP, identification of ultimate beneficiary owner, directors, C-suites, screening, and finally, risk assessment of the customer to complete KYC.
- **Additional Due Diligence (ADD):** To meet new regulations such as the EU Directive IV, Foreign Account Tax Compliance Act (FATCA), Markets in Financial Instruments Directive (MiFID), Dodd Frank, etc., banks and financial institutions need to perform additional checks before the customer is on boarded. Some banks have a different team to fulfill these requirements.
- **Local Due Diligence (LDD):** Global banks / financial Institutions need to fulfill their global standards and meet the local jurisdiction requirements to complete onboarding in that specific jurisdiction (e.g. certain jurisdictions require a Client's Board Resolution for opening an account with banks as a mandatory requirement which is not a global regulatory requirement).
- **Enhanced Due Diligence (EDD):** Any red flags identified during the KYC review, impacting the bank or financial institution, need to undergo additional checks to fulfill requirements and requires further review / approval from the financial crime team / committee review. Some examples are high risk jurisdiction, high risk line of business, high risk product, Politically Exposed Persons (PEP), sanctions, bearer share, etc.

## Errors and omissions: The cost

Akin to most regulations, KYC compliance too requires considerable amount of time, money, and effort to collect data and process it. Not surprisingly, KYC and Anti-Money Laundering (AML) have become a leading concern for the financial services industry. AML lapses have led to heavy penalties for many banks. Recently, in India, the KYC Scam brought to light monetary penalties imposed on numerous banks by The Reserve Bank of India for violation of regulatory directions / instructions / guidelines, among other things, the KYC norms. Fines for global banks have already hit $65 billion.

## A tightening noose

In addition to the existing requirements, new regulations are continually being rolled out that need to be read, understood, and applied. These new regulations impact KYC onboarding in many ways. Some such regulations are:

- **Foreign Account Tax Compliance Act (FATCA):** FATCA requires banks and financial institutions to classify customers as US or non-US based on certain attributes such as the address, mobile number, citizenship, and more. It also mandates collecting the W8/ W9 forms accordingly.
- **Markets in Financial Instruments Directive (MiFID):** The MiFID regulations were enacted to boost transparency across the EU's financial markets and standardize regulatory disclosures required for particular markets. Slated to come to effect from January 2018, the new MiFID II directive will mean more effort in complying with the law in terms of customer suitability and appropriateness, customer classification, marketing controls, and target market identification.
- **EU Directive IV:** On 25 June 2015, the EU Fourth Directive was enacted, replacing the previous third directive. The new directive goes beyond international requirements to expand the scope of transparency such as the Centralized Registers of Beneficial Owners, Risk Based Approach, and Politically Exposed Persons (PEP) checks.
- **Dodd Frank:** The act was enacted by the US Congress in July 2010 with the objective of increasing transparency and reducing risk in the Over the Counter (OTC) derivatives market, among other things. The act mandates that banks collect and keep certain reference data attributes and regulatory documentation for all trading foreign exchange counterparties including forwards, swaps, Non-Deliverable Forwards (NDFs), Non-Deliverable Options (NDOs), and options.

The complexity further increases for financial institutions that have a global presence as they need to comply with group global standards in addition to local jurisdictional requirements.

## More regulations, more complexity, more onboarding time, more overheads

Additional requirements mean more KYC procedures and more complexities, which in turn, increase the customer onboarding timeline. The time taken to onboard a customer has increased by 22% over the previous year in 2016 and is further anticipated to increase by 18% in 2017, according to a survey conducted by Thomson Reuters. The survey further cited lack of skilled resources and the volume of regulatory change as the other top concerns. Another parallel survey conducted on their corporate customers found that 89% percent did not have a good experience during the KYC process and 13% had changed their financial institution as a result.

Many banks and financial institutions are addressing the time and complexity challenge by deploying more specialized resources, spending on additional training, and building technology solutions. As a result, spending on compliance (KYC and customer due diligence) has risen considerably. In some cases, compliance spending has risen to USD500 million a year while the average spending is USD60 million a year.

## Driving change as conduits of information

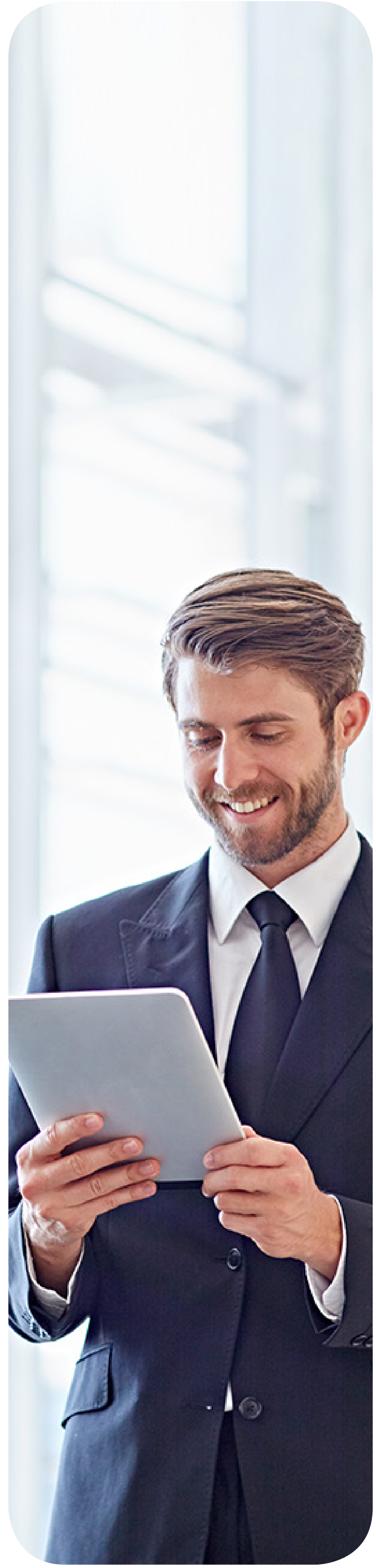
Two approaches are gaining traction to address the KYC challenges – KYC utilities and Artificial Intelligence (AI) / Robotic Process Automation (RPA). In this paper, we examine the KYC utilities market and its effectiveness.

The idea behind KYC utilities is simple: provide a central secure location to collect, qualify, and store customer KYC information and relevant documents/ proof, thereby eliminating the need to provide the same documents multiple times. Further, this information and the documents are validated from time to time to ensure that they are valid and current. This reduces the operational burden for banks and the workload for their staff.

## Clear returns

KYC utility delivers clear returns:

- Faster customer onboarding as the documents / information required are readily available
- In the long run, standardizes country / bank KYC documents required for account opening
- Reduced cost of performing KYC checks as the database is shared amongst multiple banks
- Eliminates the need to periodically confirm details as the utility takes care of updating information
- Efficient audit trails of the information / changes in the data
- Further reduced manual effort with additional services by some providers such as screening of the party details
- Improved customer experience as the dependency to request for documents / information is eliminated
- Compliance with the KYC regulatory requirements
- Reduced KYC workforce



## Infosys BPM Thoughtboard: KYC utilities to the rescue?

Currently, there are four KYC utility providers in the market, each specializing in specific business lines.

| KYC.COM | Swift KYC Registry | Thomson Reuters Org ID | KEN – KYC Exchange Net AG |
|---|---|---|---|
| Standardized set of data collected and maintained for buyside and corporate clients | Specialized in due diligence on FI's and their downstream relationships | Solution suites for retail, institutional, wealth management, and corporate clients | Standard set of ready information for banks / FI |

## Know your utility

| KYC.COM | Swift KYC Registry | Thomson Reuters Org ID | KEN – KYC Exchange Net AG |
|---|---|---|---|
| A joint venture between Markit and Genpact<br><br>Currently serving 12 of the largest global banks with over 2,200 buy side and corporate clients registered, over 113,000 legal entities in their database, and over 350,000 documents uploaded | Leverages Swift's expertise in cross border payment technology and existing tie-ups with banks to facilitate their transactions<br><br>Offers a shared platform to manage and exchange standardized KYC data<br><br>Has tie-ups with the world's largest correspondent banks to define the data set and documentation to address KYC requirements across multiple jurisdictions | First mover with its Accelus Org ID<br><br>Has a good footprint with their recent acquisition of Clarient global LLC.<br><br>Performs KYC due diligence by collecting, classifying and verifying a customer's identity against a globally standardized policy<br><br>Continually monitors identity to detect changes in the legal entity status | Developed by industry experts<br><br>Aims to rationalize and standardize the common elements of the KYC process to on one hand, enable banks to save cost and work more efficiently, and on the other, allow the financial services industry to maintain and monitor a globally connected network of correspondent banks and relationships |
| 10 participants:<br>• Bank of America<br>• Merrill Lynch<br>• Bank of Montreal<br>• BNP Paribas<br>• Citi<br>• Deutsche Bank<br>• HSBC<br>• Morgan Stanley<br>• UBS<br>• Wells Fargo | 8 participants:<br>• Erste Group Bank<br>• Lloyds Bank<br>• Raiffeisen Bank<br>• Citi<br>• JP Morgan<br>• Deutsche<br>• HSBC<br>• Standard Chartered | 5 participants:<br>• Barclays<br>• Credit Suisse<br>• Goldman Sachs<br>• JP Morgan<br>• State Street | 4 participants:<br>• Commerzbank<br>• Societe Generale<br>• Standard Chartered<br>• DZ Bank AG |

*Note: Details tabulated are based on the information available in utility provider's website / public sources*

## What sets them apart?

| KYC.COM | Swift KYC Registry | Thomson Reuters Org ID | KEN – KYC Exchange Net AG |
|---|---|---|---|
| Managed customer outreach and due diligence across customer types, jurisdictions, and asset classes | Specialized in KYC data for correspondent bank customers<br><br>Standardized set of data and supporting documents<br><br>Aggregate view of incoming and outgoing payments to high-risk or sanctioned countries | The only utility provider to provide ongoing screening, training and monitoring of KYC<br><br>Screens entities and identifies risks<br><br>Sources legal entity documents in over 200 countries and 60 languages | Specialized in KYC data for correspondent bank customers<br><br>Facilitates the exchange of up-to-date and tailor-made KYC information fast and efficiently with audit trails and in an electronic process-friendly format |

## Benefits delivered: How the foursome fare?

| Utility Providers | Business line coverage | AHT Reduction | TAT Reduction* | Improve Customer Experience* | Re-use of Data/ Docs | Cost** |
|---|---|---|---|---|---|---|
| KYC.com | ◑ | ◔ | ◔ | ◔ | ● | ○ |
| KYC Registry | ◔ | ◔ | ◔ | ◔ | ● | ○ |
| Org ID | ◕ | ◑ | ◔ | ◔ | ● | ○ |
| KEN | ◔ | ◔ | ◔ | ◔ | ● | ○ |

* *Though utilities help complete certain sections of the KYC activities (i.e., MDD / SDD / some sections of EDD), the rest of the activities still need to be performed by the banks themselves. Hence, utilities do not have control in reducing the overall TAT and improving customer experience.*

** *Increased coverage of business lines, entity coverage, geography coverage, language capabilities, enhanced coverage such as screening, risk assessment, and more banks subscribing to utility providers – all these factors lead to cost benefits. At this point, all utility providers lack global coverage and have only a handful of banks subscribed to their services. Hence, the cost benefits are not much.*

## The caveat!

While there are some clear benefits of subscribing to KYC utilities, there are some concerns as well, which need to be addressed:

- Although all the KYC checks are done by the utility provider, the liability still lies with the bank to validate and approve customer onboarding / refresh
- May give rise to data privacy issues due to cross border sharing of information
- Inconsistent risk-based approach of banks to accept certain documents / information
- Non standardized utility provider information:
    - Coverage largely limited to MDD, SDD, partly EDD and some manual effort is needed to complete these activities
    - The onus to comply with additional regulatory requirements such as Dodd Frank, MiFID, FATCA, EU Directive IV and LDD lies with the bank
    - Does not cover all customer business lines – retail, wealth, investment banking, and FIs
    - Does not have global population / coverage of customer data
    - Language barriers in translating documents / information exists
    - Limited geographical coverage

## To collaborate…or not?

Without doubt, a utility is a differentiated model that leverages collaboration and sharing of information. However, in their current state, they are insufficient. Presently, different utility providers specialize in specific business lines with their coverage limited to certain geographies and languages. Although they support certain key activities such as beneficiary ownership, controllers, CIP, and more, banks need to carry out the rest of the activities such as local due diligence, additional due diligence, product due diligence, risk evaluation of customers, screening of the related parties, etc. Getting global coverage of data across all business lines and covering multiple languages is a major challenge. Hence, a few regional utilities are evolving to meet local needs such as the Monetary Authority of Singapore (MAS), which is piloting a national KYC utility. This will help local banks to perform their KYC process effectively.

Banks have their own way of performing KYC checks and their risk acceptance approaches differ. Hence, for the utility concept to be successful, the KYC process has to be standardized across all banks, the risk-based approach made consistent, and the documents validity and certification criteria standardized across all banks and regions. Finally, complete support from regulators will be key as the bigger question for banks and utility providers is "how soon will regulators accept them?"

So are KYC utilities a viable solution? Not so much in their present form. That said, if the concerns highlighted above are addressed, they would certainly be of great help to banks and financial institutions in improving their onboarding timelines, cutting down their costs by leveraging shared information across peer banks, ensuring better customer experience, and finally, meeting regulator expectations.

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Shan has extensive experience in the know your customer (KYC) and anti-money laundering (AML) domain, and has handled large scale operations, regulatory projects, project migrations and transitions. He has supported various global banks – Standard Chartered, Bank of Montreal, Barclays and JP Morgan Chase Bank – in setting up AML operations teams, and laying the foundations for their compliance teams. He is an ACAMS certified AML specialist.

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