How to better understand your customers using context

A guide to transforming your KYC processes

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Connecting data | empowering decisions

Transform your customer understanding with context

With laborious onboarding, refresh and remediation processes, the challenge of **Know Your Customer** (KYC) compliance is continuously growing. Since KYC is outdated almost as soon as it's completed, you are reliant on static and time-limited data to understand your customer and their risk.

By adopting a contextual approach, you can reduce the time and cost of KYC by increasing automation and leveraging decision intelligence for continual monitoring. Increasing regulatory, cost and customer pressures demand a new way of thinking.

Context is the missing link.

Quick links

The three waves of KYC evolution

1

KYC and AML regulation emerges globally

Money laundering and financial crime has long been an issue concerning national government. But the establishment of the Financial Action Task Force (FATF) in 1989 is often seen as the starting point for global efforts to combat money laundering, especially involving coordinated action by financial institutions.

Published in 1990, FATF's original "40 Recommendations" started to address the need for KYC, particularly around customer identification and verification. The September 11th terrorist attacks spurred the USA PATRIOT Act, intensifying financial crime efforts and the countering of terrorist financing.

2

Big fines as regulatory standards increase

In 2012, U.S. authorities fined financial institutions billions of dollars for failings in financial crime controls – many relating to KYC. This triggered a dramatic increase in KYC-related fines globally and kickstarted the focus on KYC within financial institutions.

With increasing regulations, many global financial institutions had to remediate their KYC files to improve checks across huge portions of their customer base. This often required the use of expensive external consultancies and look-back exercises which incurred high levels of project-related costs. It further resulted in expensive investment in entirely new BAU processes, people and technologies.

3

The cost of compliance continues to grow

As KYC requirements become increasingly stringent due to new regulations such as the EU 5th and 6th Money Laundering Directives, the cost of compliance continues to escalate – and so do negative customer experiences. KPMG estimates a 16% annual increase in due diligence costs. But while established financial institutions spend more on KYC than ever, challenger firms are adopting innovative KYC processes to create competitive advantage.

Organizations are trialing automation, robotics and AI within KYC but are yet to reach a true transformation. The missing ingredient is context. Using context, financial institutions can finally transform KYC processes from reactive compliance to proactive risk management.

“Only 18% of financial institutions proactively take actions when an event occurs to trigger a KYC review”

- Refinitiv, 2017

KYC onboarding and refresh continue to drive cost and complexity

While customer onboarding continues to present a challenge for financial institutions, most firms struggle even more with the need to continually monitor their existing customer relationships for signs of high-risk activity.

When customer refreshes are performed, Refinitiv estimates that the process takes an average of **20 days** to review a corporate customer and requires **three separate customer contacts.**

40%

KYC accounts for over 40% of a financial institution's overall cost of AML compliance.

34%

Despite the rise in headcount, 34% of financial institutions cite a lack of resources as the biggest challenge in conducting KYC and CDD processes.

80%

Up to 80% of AML/KYC efforts is committed to information gathering, rather than analyzing and monitoring data for critical intelligence.

The regulatory landscape is constantly changing

Over the past decade, financial institutions have faced increasingly more stringent AML and KYC regulations, which vary across geographies. As financial institutions battle to adhere to KYC requirements, there are growing backlogs of unreviewed cases holding undetected risk.

Global

FATF's updated set of recommendations in 2012 remain standard guidance for financial institutions globally around identification of customers and ownership.

In March 2020, FATF issued new guidance on the use of digital identity which sets new recommendations on its use within CDD.

Europe

In 2017, 4AMLD emphasized the need for the full implementation of a risk-based approach, with specific provisions on beneficial ownership, enhanced due diligence and changes around the definition of a PEP. As of 2020, 5AMLD introduced new legal requirements for the recording of beneficial ownership. 6AMLD will come into effect in 2021 and is expected to continue to raise the bar in relation to KYC.

Hong Kong

In June 2019, HKMA issued feedback to financial institutions following a CDD thematic review highlighting that customers' financial crime risk assessments should be ongoing and dynamic, not based on static information collected at onboarding.

Canada

In 2019, FINTRAC amended regulation to require renewed focus on evidencing the accuracy of beneficial ownership details and expanding CDD requirements to additional business types.

United States

In 2018, FinCEN issued new guidance on its CDD Rule, clarifying points around calculation and identification of beneficial ownership for legal entity customers.

The OFAC 50% Rule creates additional complexities for determining whether a customer has owners or controllers that are considered sanctioned.

Australia

AUSTRAC has issued guidance for performing due diligence during the COVID-19 pandemic, particularly around the use of remote onboarding and verification of customer data.

Singapore

In 2020 Singapore's ACRA announced plans to build a central, non-public register of beneficial ownership for Singaporean companies.

Ineffective KYC increases your reputational risk

Financial institutions face a multitude of challenges with existing KYC processes throughout the customer lifecycle, which increase reputational risk, raise the cost of compliance and damage customer relationships. These include:

Ineffective systems are missing risk

Rudimentary risk assessments are often carried out on static variables, such as geography, rather than dynamic variables, such as observed behavior. Existing systems do not consider network risk, instead looking solely at isolated events, which results in missed risk.

Poor quality data

Manual processes result in data captured in different formats or using default values due to heavy workloads. Detailed quality assurance and control are required to ensure errors do not slip through.

Focus on technical compliance

Due diligence is generally still considered to be a compliance activity rather than a holistic, strategic business process that can strengthen and add value to customer relationships and increase customer understanding.

Customer outreach results in poor customer experience

Due to the reliance on data provided by customers to complete KYC profiles, multiple outreaches to customers are often required. This negatively impacts customer experience, increases customer churn and delays in opening an account equate to revenue losses.

Manual processes are time-consuming and error-prone

Human analysts spend vast amounts of time trawling through internal and external systems gathering and preparing data.

There's more to KYC than onboarding

Onboarding

Financial institutions often lack a single customer view, meaning you can't tell if you already hold a relationship with new customers.

Without a complete understanding of a prospect or customer, it's difficult to effectively assess their financial crime risk.

This requires you to repeatedly reach out to customers, not only resulting in extensive time and expense to onboard them, but also a poor customer experience and high customer drop-out rates during the process.

Ongoing due diligence

There is a regulatory expectation to keep KYC profiles up to date to inform other financial crime controls, such as transaction monitoring. However, KYC is outdated almost as soon as it's collected.

Periodic reviews are handled manually, resulting in huge backlogs and potentially missing customer risk between KYC reviews. After opening an account, customers are less incentivized to engage with you to provide updated information. A low-risk customer may move to a high-risk jurisdiction but with current processes, this wouldn't be uncovered for up to five years.

Without context, it's impossible to know if a customer is transacting with a high-risk company, or if they have a new high-risk owner. To gain a complete understanding of a customer and their risk, you must assess their entire network.

Exit

Lacking a single customer view makes it challenging to effectively offboard customers due to the difficulty ensuring you've exited the relationship across all products and business lines.

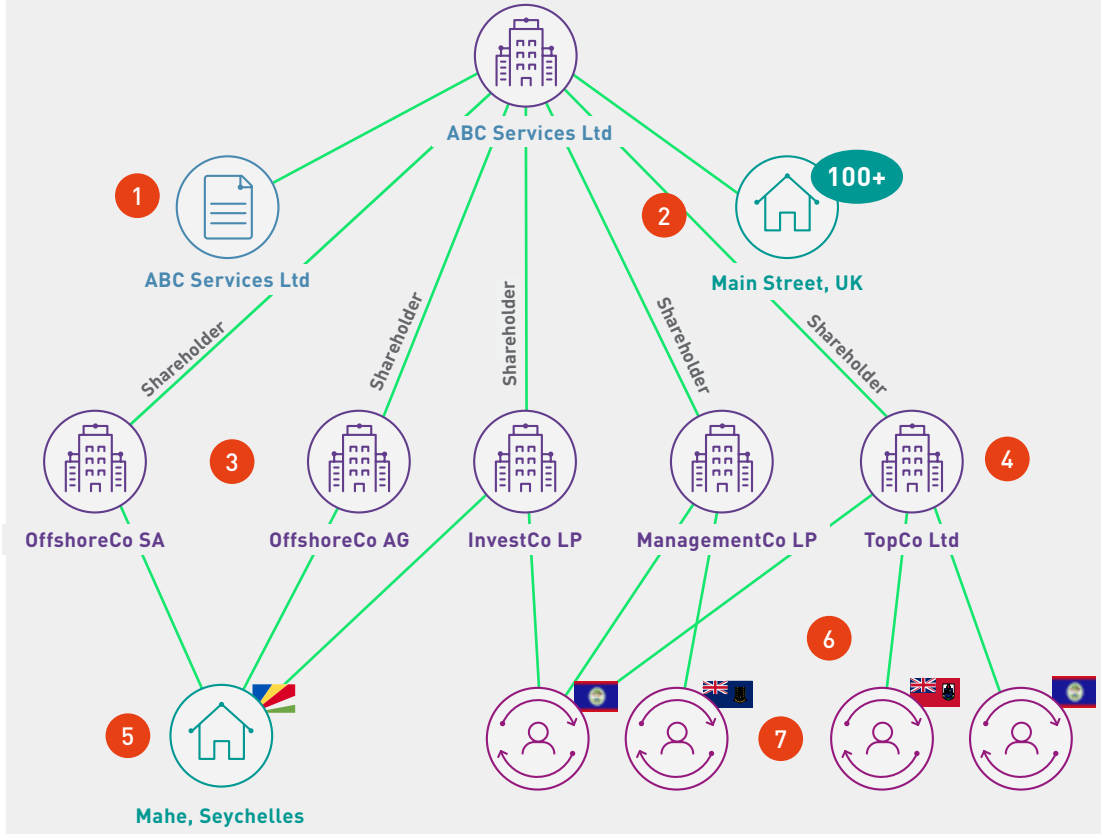
It is also difficult to prevent the re-entry of an offboarded customer without context, which would automatically identify exited customers through network analysis, such with phoenix operations.

"On average corporates have had six material changes over the last 24 months, but only 30% had made their financial institution aware of all the changes. By failing to implement ongoing checks, financial institutions are increasing their risk exposure through involvement with clients who may be undertaking new activities or entering new relationships that are not disclosed."- Refinitiv, KYC Compliance survey

Case study

Azerbaijani Laundromat

The *Azerbaijani Laundromat* scheme washed nearly $3 billion of illicit and corrupt funds through a series of shell companies and companies with highly complex and opaque ownership structures. Examining the companies involved in this and other similar schemes reveals several common risk factors that should have raised concern about the nature and purpose of the transactions these companies were engaging in. This helps to demonstrate why effective KYC is a critical foundation to accurate financial crime detection and prevention.

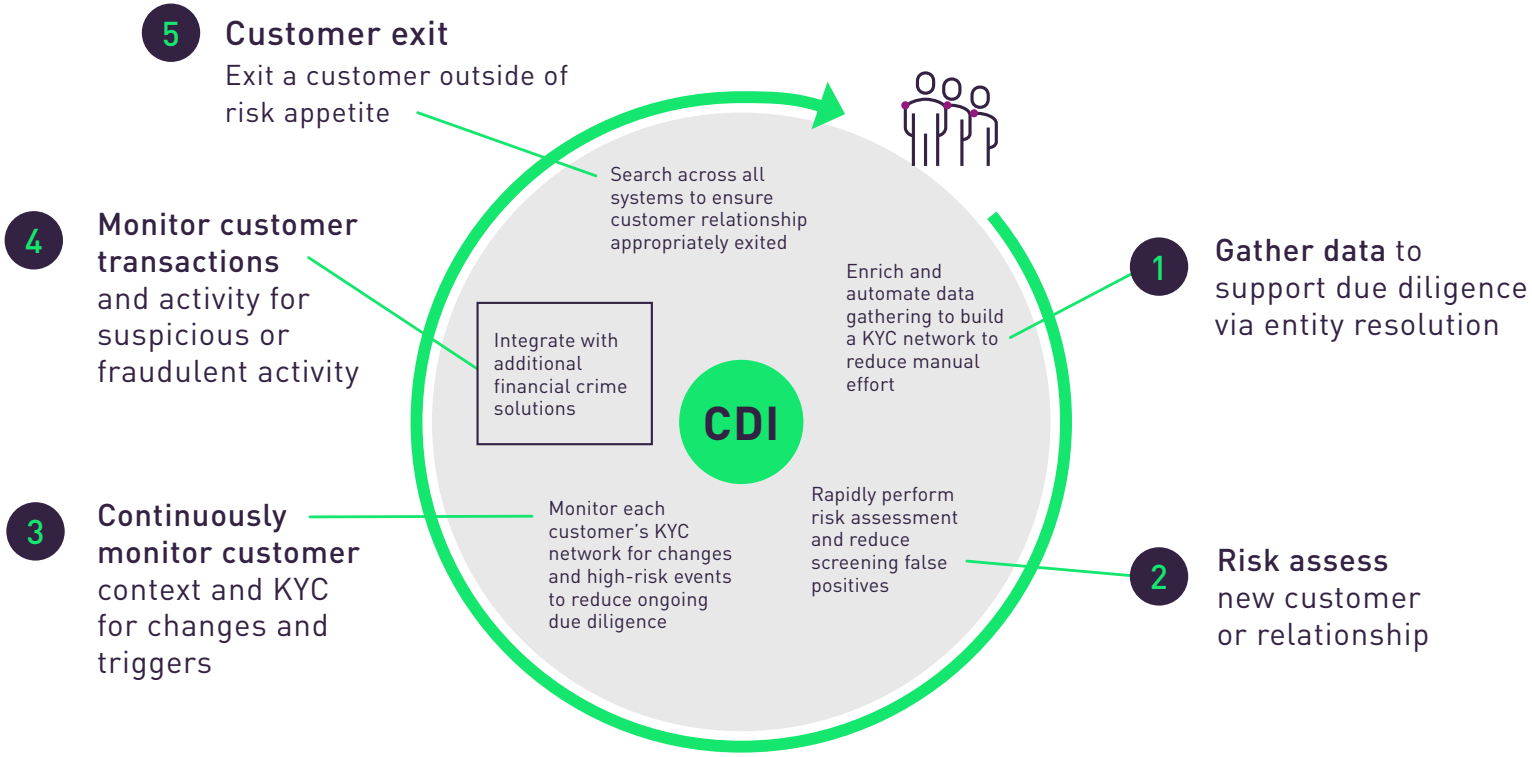


Key risk factors

1. Financials show very low assets or a SIC code indicating dormant or non-trading status
2. Registered address is shared by several other companies indicating the potential use of a companies formation agent
3. Corporate suffixes do not match incorporation address. Similar incorporation dates for related businesses
4. A large number of partners and owners listed, potentially to avoid triggering ownership thresholds
5. Shared addresses show evidence of shell company status
6. Frequent changes in ownership
7. Individuals with many different nationalities in offshore jurisdictions

Context throughout the customer lifecycle

Contextual KYC helps to refocus the entire financial crime control framework to be more customer centric. Using contextual decision intelligence (CDI) to continuously evaluate each customer and their financial crime risk throughout the customer lifecycle, this approach increases efficiency and effectiveness by breaking down barriers between previously siloed financial crime processes.



How to overcome KYC challenges with context

Contextual Decision Intelligence is a new approach to data that enables you to connect multiple internal and external data sets to provide a single view of customers enriched with intelligence about the relationships between people, organizations and places. Understanding this **customer context** is to key to automatically gathering data, and dramatically improving efficiency, effectiveness and consistency of KYC.

Entity resolution

Connect your data to create a single customer view

Connect billions of internal and external data sources—like KYC profiles, corporate registry data and transactions - to create a single customer view and understand a customer and their risk, even before onboarding.

Network generation

Highlight new or changing risk levels

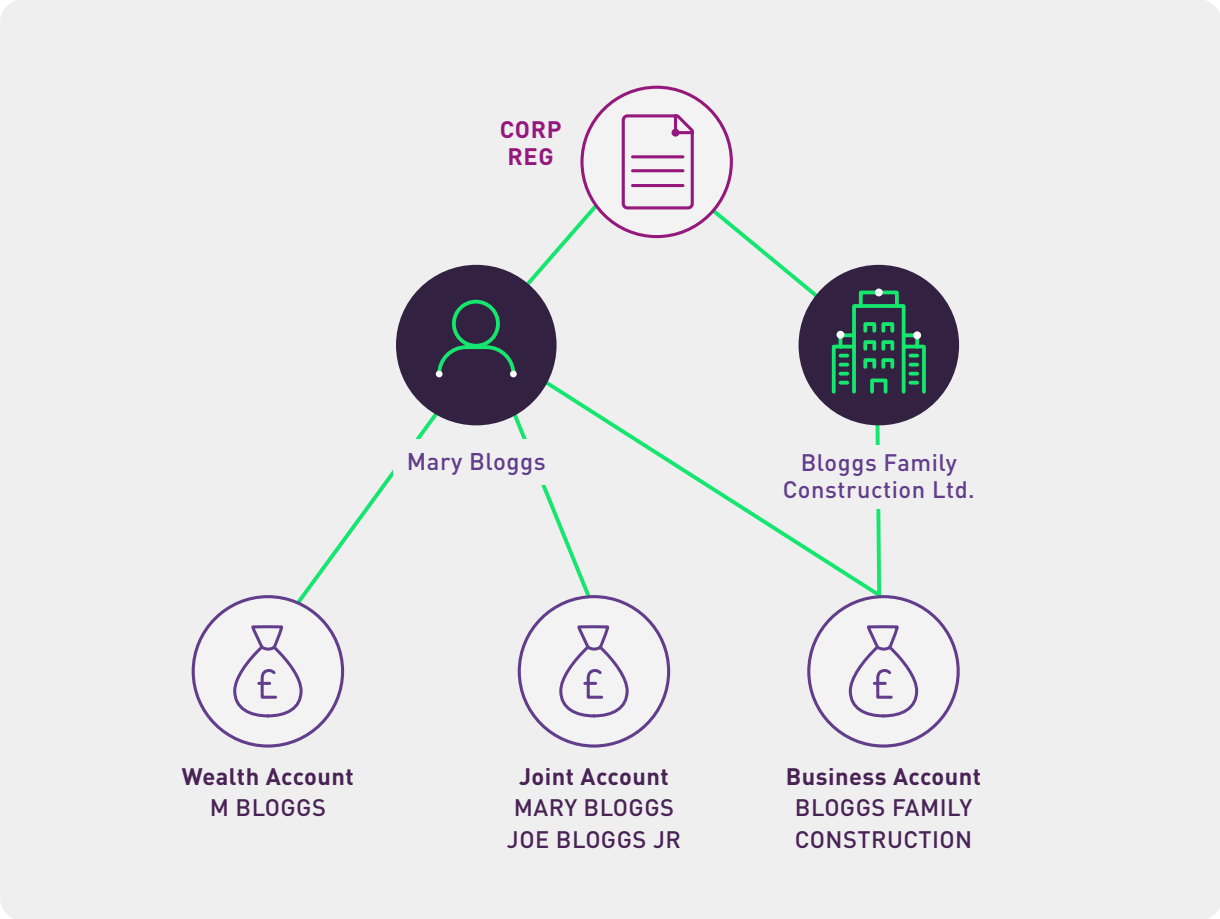
Use dynamic network generation to automatically highlight new or changing risks associated with your customer, including transactions. Reassess the customer risk score in real time to detect risk as they emerge.

Network monitoring

Reflect and continuously monitor changes in your CLM

Automatically update your customer's KYC record in your CLM or KYC system to reflect changes in their information and risk profile. Move away from periodic reviews with continuous monitoring.

Entity resolution: Creating a single view of customer

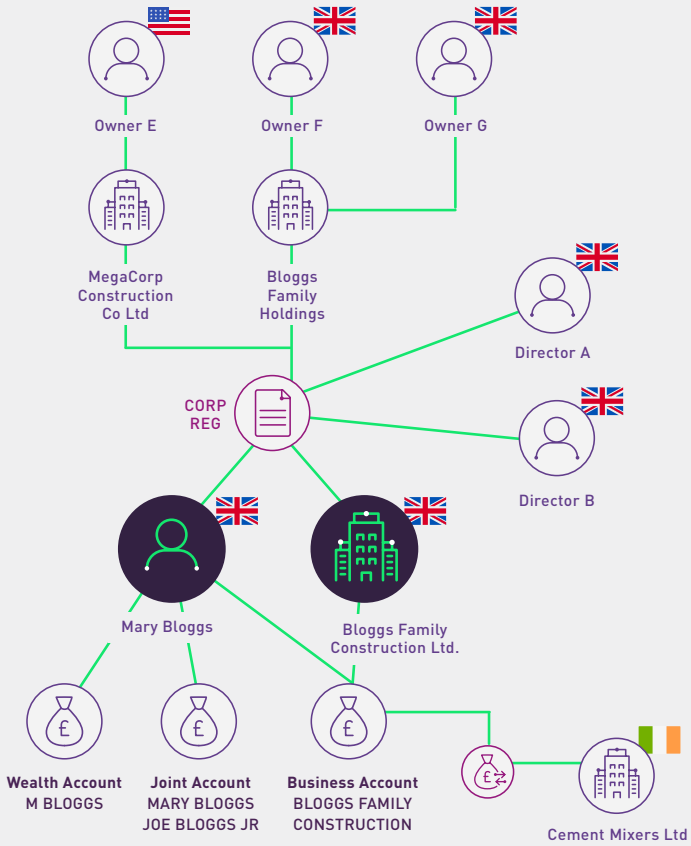


Entity resolution allows you create a single view of your customers and their relationships across your organization using internal and external data sources.

In this example:

- **Mary Bloggs** has been identified as the same person across her Wealth, Joint and Business accounts, despite differences in data within internal systems.
- The business **Bloggs Family Construction Ltd** has also been identified as a customer with a business account, which is linked to Mary Bloggs
- Using third-party data to enrich internally-held information, both **Mary Bloggs** and **Bloggs Family Construction Ltd** are identified as the same person and business referenced in an external **corporate registry** database.

Network generation: Building a broader context for your customer



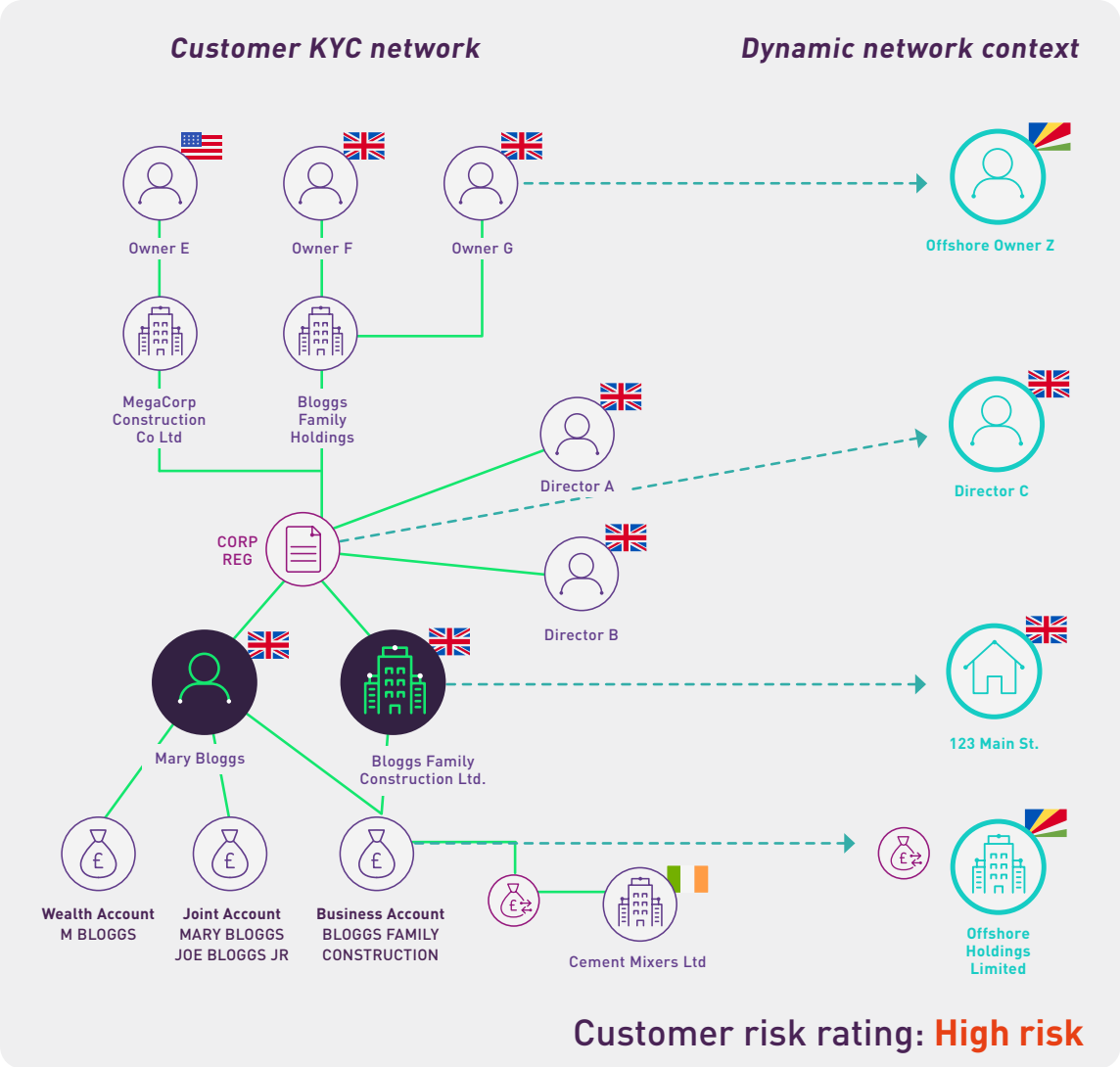
Customer risk rating: **Standard risk**

Network generation builds on entity resolution by expanding your understanding of a customer beyond just the customer itself – and puts that customer in context.

In this example, by building this customer's relevant KYC network, we can:

- Identify the ultimate beneficial owners of Bloggs Family Construction Ltd, **Owner E, Owner F** and **Owner G**
- Identify the corporate hierarchy and intermediate parent companies, **MegaCorp Construction Co Ltd** and **Bloggs Family Holdings.**
- Identify the directors, addresses, financial data and more, available on corporate registry databases, such as **Director A** and **Director B.**
- Maintain our resolved view of the original customers, **Mary Bloggs** and **Bloggs Family Construction Ltd.**
- Understand key transactional network information, such as **Cement Mixers Ltd** being a significant counterparty of the business account for Bloggs Family Construction Ltd.

Network monitoring: Updating risk in real time



Continuous KYC monitoring allows you to dynamically update your customer context and their associated financial crime risk when information changes, in real time

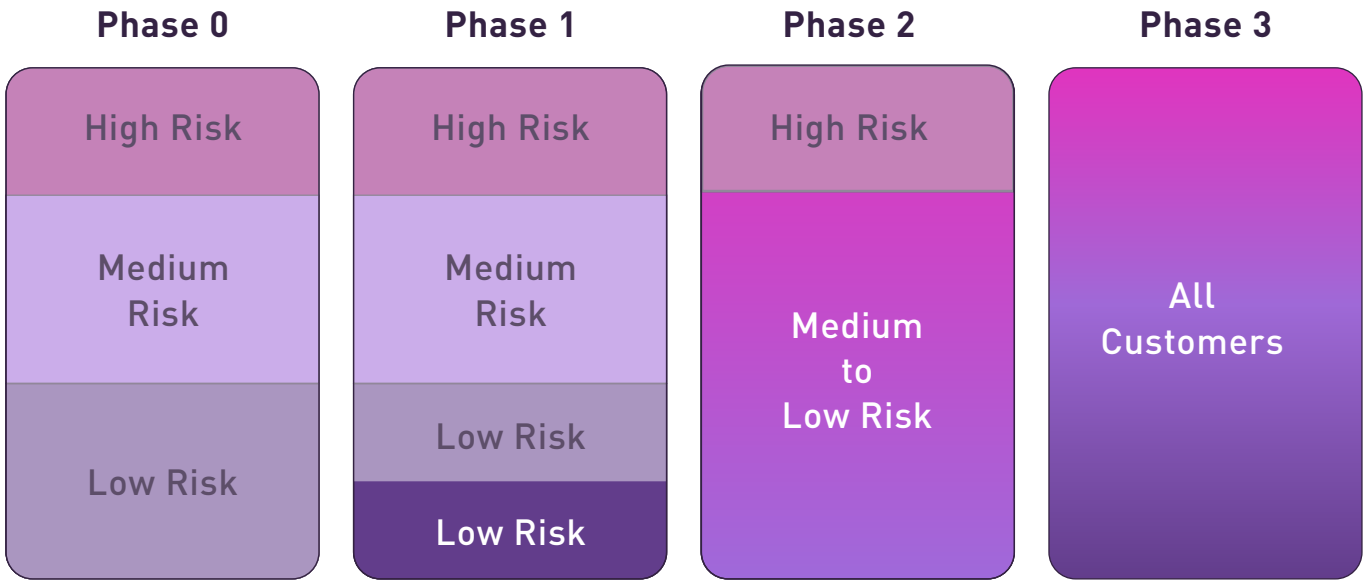
In this example, we can:

- Immediately detect a **change in beneficial ownership** to a new owner based in a high-risk jurisdiction through third-party data **(Offshore Owner Z)**
- Identify the **addition of a new director (Director C)** using third-party or internal data and they can immediately be screened, risk assessed, and added to the customer's KYC record
- Detect a **change in address** from corporate registry data (**123 Main St.**) which can immediately be risk assessed and automatically be sent to the customer via a digital channel for review and acceptance
- Detect **a new significant counterparty** based in a high-risk country via transactional data and add to the customer's risk profile (**Offshore Holdings Limited**)

Considering all these changes to the customer's network context suggests that the customer is now high risk and should be immediately reviewed for financial crime concerns.

Moving from static to continuous KYC

- **Start small and prove the model:** Choose a particular book of business, country or customer type to start with to demonstrate business benefit quickly
- **Build a business case:** Articulate both the efficiency (time and effort savings) and effectiveness (risk reduction and controls improvement) benefits of continuous KYC
- **Get the technology right:** A contextual decision intelligence platform is critical in allowing you to bring together multiple data sets, build context and detect risk



Phase 0 is KYC today - static, time-based review processes with static risk ratings and outdated customer information.

In **Phase 1** you can start small and implement continuous KYC for a low complexity book of business to prove the model. Or alternatively focus on your highest risk customers first for the biggest risk uplift.

In **Phase 2** you can expand and bring all customer types into scope, creating a full dynamic risk assessment and removing binary risk levels. Customer risk events can be assessed as they happen.

Phase 3 provides full, continuous KYC across the entire customer data set, with all customer risk assessed dynamically. Periodic refresh is eliminated or minimized as all information is continually up to date.

Create a more efficient and effective approach with contextual KYC

- Consider the customer's entire network and context to help you make a risk decision
- Bring together and intelligently resolve any number of internal or external data sources to provide a single view of your customer or prospect
- Continuously monitor all sources of customer data for changes to constantly have an updated KYC and risk profile.
- Move away from a static, customer-centric view of the world

Efficiency

Reduce processing time

Automatically populate onboarding and refresh KYC forms and spend less time looking through false positives

Effectiveness

Spot hidden areas of risk

Use your customer's entire network to find areas of risk, including with connected parties or transactions

Customer experience

Improve customer experience

Dramatically reduce end-to-end processing time and minimize customer friction

Using Contextual KYC to improve controls across financial crime

Contextual KYC is the foundation for better risk management across the entire financial crime control framework.

Using the context provided by better understanding your customers you can improve:

Customer / counterparty name screening

- Use network information to discount or prioritize alerts, for example by considering the geographies, counterparties and entities a customer is connected to within the network.

Transaction monitoring

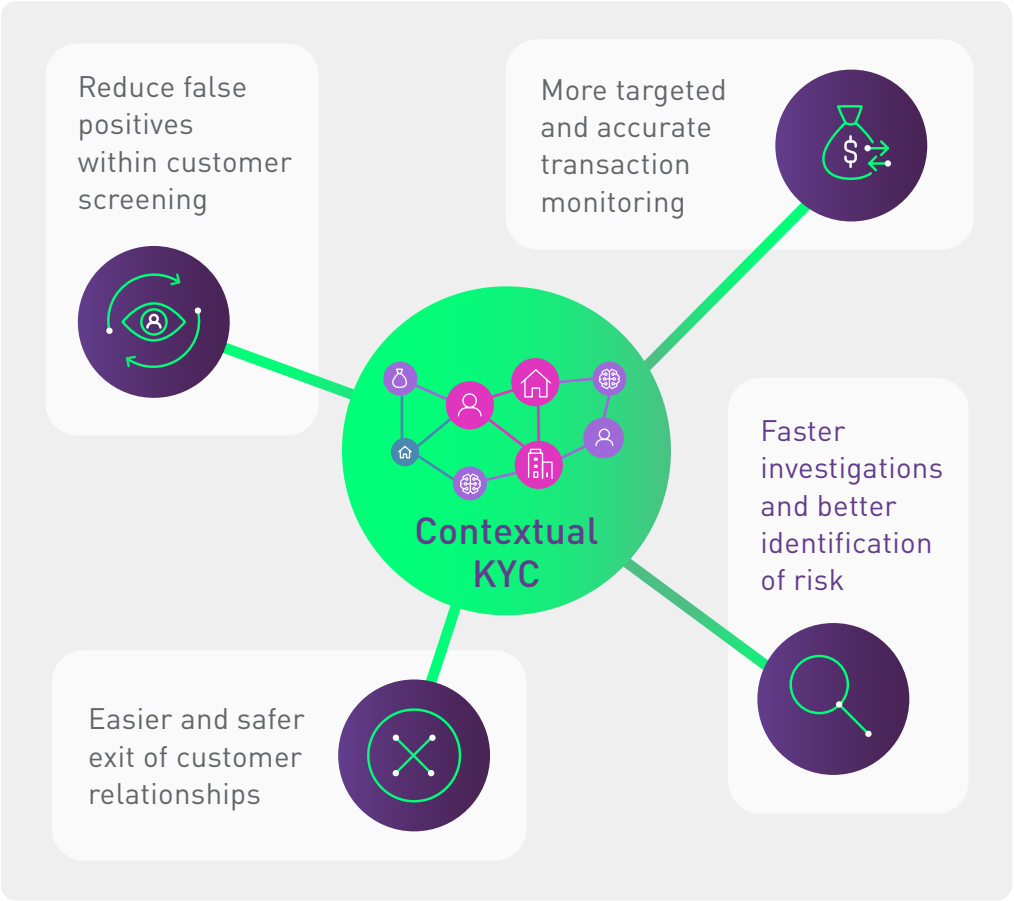
- Reduce false positives by using context to determine normal transaction patterns, for example showing payment flows between companies within the same corporate structure.
- Use a dynamic risk assessment to provide more targeted transaction monitoring for high risk customers.

Investigations

- Up to date customer KYC at your fingertips for all types of financial crime and fraud investigations.

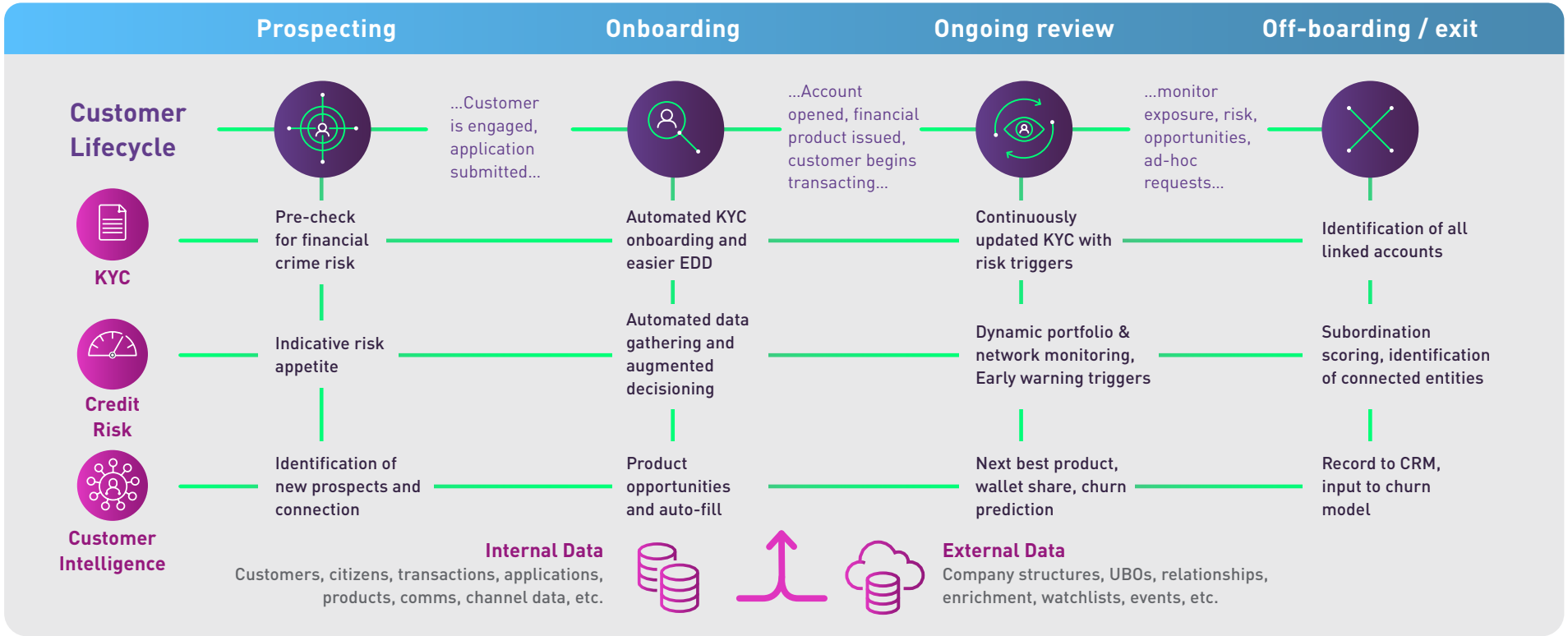
Customer exits

- Confidently exit customer relationships, ensuring that the relationship is fully exited in all business lines through accurate entity resolution.



One platform for KYC, credit risk and customer intelligence

When you understand your customers inside-out, you can see new opportunities, spot hidden risks, and speed up the information-gathering process. Contextual decision intelligence allows you to address these three applications across the customer lifecycle in one place, in a single build, using the same data.

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