CAPCO

THE JOURNEY TOWARDS
REALLY KNOWING YOUR CLIENTS

THE TIME FOR CHANGE IS NOW

INTRODUCTION

Constantly increasing complexity and standards in global regulation are leaving financial institutions struggling to keep up with new demands – so much so that reportedly 33 percent of financial services firms complain that the volume of changing global regulation is a key challenge in the KYC process[1]. Only 8 percent[2] of financial institutions believe their clients are proactive in reporting material changes in their circumstances and consequently, key changes are only picked up at periodic reviews. Despite the large rise in headcount in KYC-related compliance teams[3], 34 percent[4] of financial institutions say that lack of resources is the biggest issue in conducting KYC and related due diligence processes.

These challenges have contributed to firms being hit with $36 billion[5] in anti-money laundering (AML), Know Your Customer (KYC) and sanctions fines since the 2008 crisis, with US regulators handing out 78 percent of this total cost[6]. Fines in 2019 increased by 160 percent[7] compared with fines in the year before. As important as the direct financial impact is the reputational one – market analysis has found that reputational impact to firms can be as much as 9 times higher than total fines and compensation, once the reduction in market capitalization, forced remediation and withdrawal from prescribed activity is taken into account[8]. In addition, a challenged KYC process leads to poor client experience – 83 percent[9] of those surveyed at financial services firms thought that poor client experience seriously impacted the client lifetime value and therefore revenues.

The problems with KYC are not for a lack of trying, however. Firms are forecast to spend an astonishing $181 billion in compliance-related cost, with $137 billion[10] of that total spent in the EU alone. Banks just cannot get away from the legacy problems of KYC:

- **Resource Intensive (Especially on High Risk Customers):** Large human effort required to collate and validate information and perform client outreach

- **Client Unfriendly:** High friction servicing with slow time to product access

- **High Backlogs:** Traditionally results in large periodic review backlogs for banks to work through

- **Costly** increased resource numbers often required, as well as vendor costs and punitive fines.

An inability to monitor risk on a more real-time basis and a lack of automation perpetuates these problems. Without a rich network view of clients that is frequently updated, banks forego additional benefits of really knowing their clients such as effective cross selling of products and services based on a client's individual needs.

In this paper, we will share the journey towards really knowing your clients, and how perpetual KYC is at the heart of this.

pKYC IS A BIG OPPORTUNITY
AND NOW'S THE RIGHT TIME TO CAPITALIZE

Let us envision a state of KYC, done right. Where internal and external impacts to a risk change are flagged immediately and immaterial events dispositioned automatically. Ability to understand and manage client and reputation risk? Tick. Deeper understanding of your client base? Tick. Reducing cost and finally turning those drained dollars and resources to innovation opportunities? Tick.

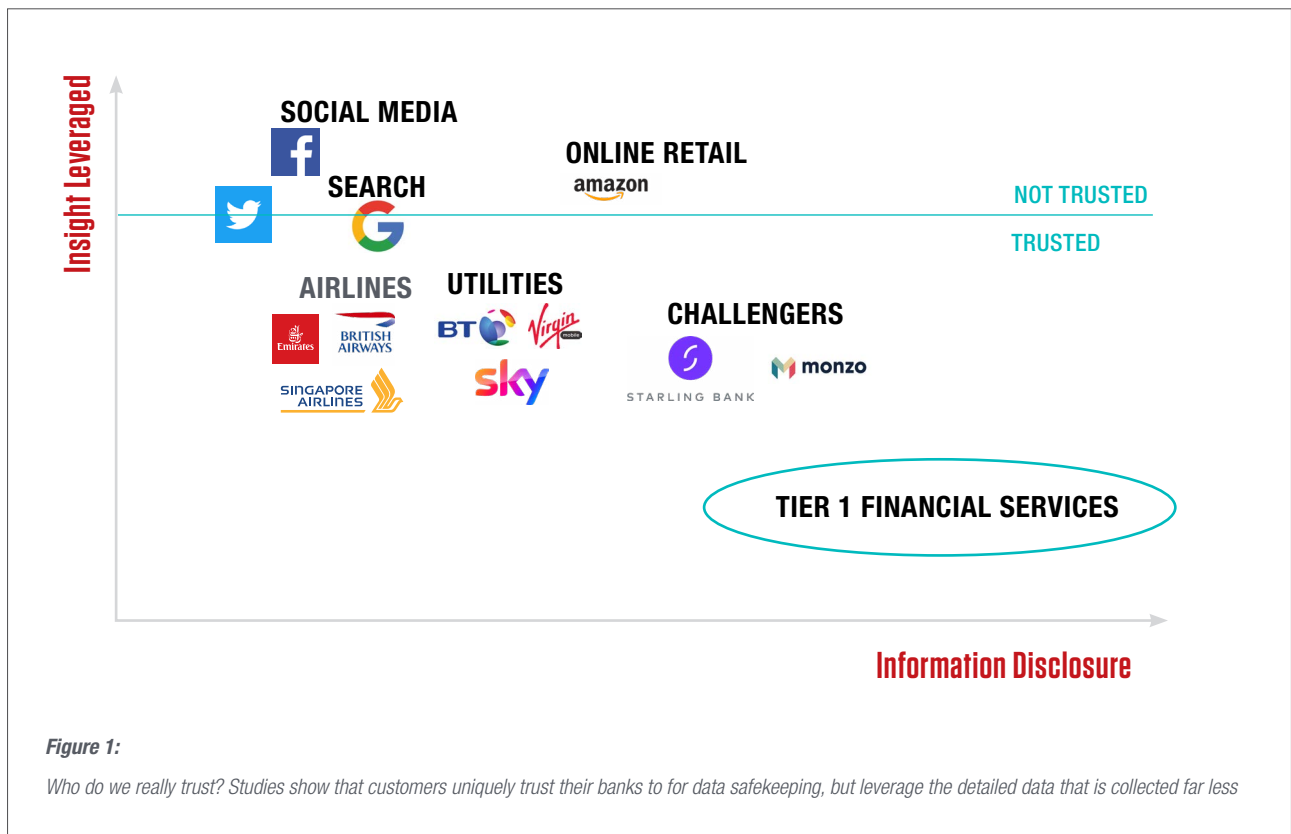**Welcome to the vision of Perpetual KYC (pKYC).**

> *In the Chinese language, the word crisis is composed of two characters, one representing danger and the other opportunity.* [11]

John F. Kennedy

Banks today have the ripe opportunity of moving to pKYC and achieving this vision. They are in the unique place of having mammoth amounts of data on each client and being trusted by their clients to use that data, if it leads to better servicing.

Yet, still, banks are doing very little to leverage the wealth of data available to them.

Figure 1:

Who do we really trust? Studies show that customers uniquely trust their banks to for data safekeeping, but leverage the detailed data that is collected far less

Let's have a think about all the different types of data available to a financial institution. Firstly, there is the wealth of information collected during the onboarding process: information about legal entities, key suppliers, key customers, countries of operation, company ownership and much else besides all this. Secondly, when a client has been onboarded and has started transacting, there is an ever-increasing amount of data about their transaction history: what products are they transacting, how frequently are transactions being made, transaction size, etc.

The challenge has historically been that all this data has sat in siloes around the firm, meaning it is hard to leverage insights from it. Your pKYC journey starts when you begin to stitch together all these data sources to have a single enriched view of the client. This enriched client view can begin to be supplemented by external data. How much time would it save if material changes to the client's situation and/or transaction patterns are flagged automatically rather than being reviewed at defined time intervals? A lot, clearly.

So, rather than having a 'siloed' view of the client, the 'network' view emerges instead:
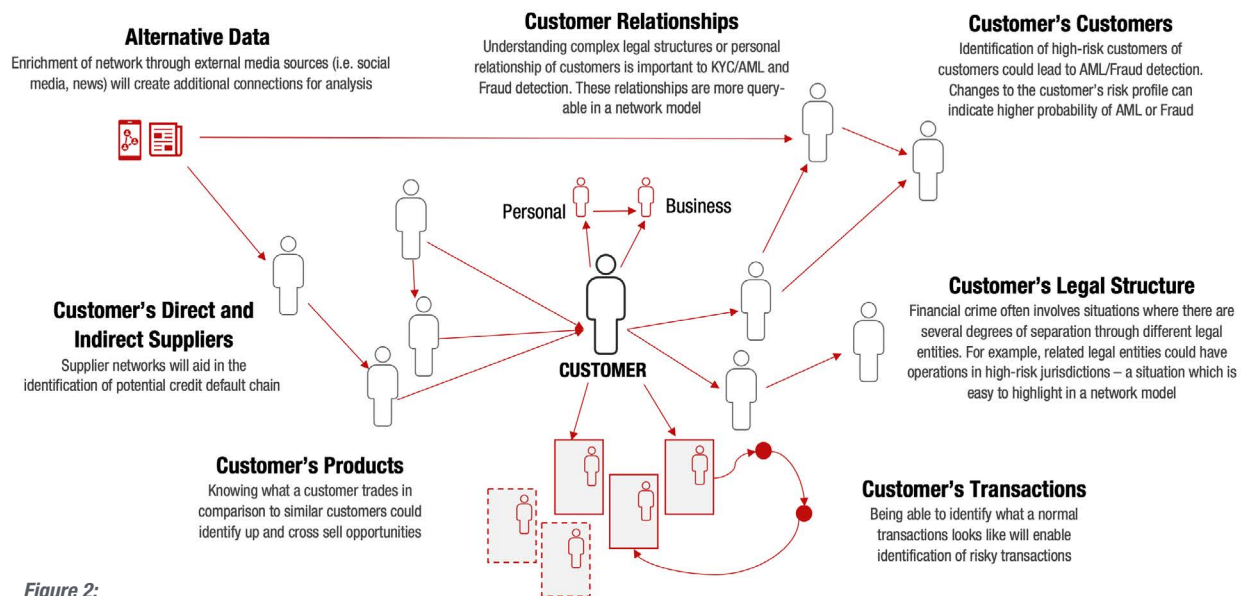
Alternative Data
Enrichment of network through external media sources (i.e. social media, news) will create additional connections for analysis

Customer Relationships
Understanding complex legal structures or personal relationship of customers is important to KYC/AML and Fraud detection. These relationships are more queryable in a network model

Customer's Customers
Identification of high-risk customers of customers could lead to AML/Fraud detection. Changes to the customer's risk profile can indicate higher probability of AML or Fraud

Personal → Business

Customer's Direct and Indirect Suppliers
Supplier networks will aid in the identification of potential credit default chain

CUSTOMER

Customer's Legal Structure
Financial crime often involves situations where there are several degrees of separation through different legal entities. For example, related legal entities could have operations in high-risk jurisdictions – a situation which is easy to highlight in a network model

Customer's Products
Knowing what a customer trades in comparison to similar customers could identify up and cross sell opportunities

Customer's Transactions
Being able to identify what a normal transactions looks like will enable identification of risky transactions

Figure 2:

The network view of the client

THIS SOUNDS GREAT BUT
A LONG WAY IN THE FUTURE, SURELY?

Not so - the pKYC journey can be built iteratively. Wherever you are in your maturity, pKYC provides benefits and puts you on the strategic pathway to achieve automated event-driven KYC. The core building blocks to a solution is a basic workflow and entity resolution. Various external data feeds can then be added to enhance the foundations.

External data sources are numerous and choosing them well is an important decision to make. We do not recommend a 'one-size-fits-all' approach. These would vary from firm to firm in order of business priority and the strategic decisions that each firm is trying to unlock and the cost vs. business benefit to unlock that data set.

From this foundation, an event engine can look for material changes in these data feeds and highlight them when appropriate. Incremental datasets and workflows can be added in line with business priorities. As each additional dataset is added, the 'network' view can be built up and can be refreshed to show new connections, allowing an increasingly enriched view of the client to be built up over time.

First though, it is important to recognise where you are in your pKYC journey:

Where are you in your KYC Maturity?

The Journey towards **really** getting to know your clients

1

DISJOINTED

- KYC processes are all manual or use non-dedicated tools like Excel or Outlook to allocate / track / report

- Process status info is also siloed, so multiple outreaches / duplication / inconsistency

- KYC / Sales / Fraud / Sanctions all work in siloes, may not trigger wider reviews

- Global standards with inconsistency across countries / departments / exceptions

2

REACTIVE TO RISK

- Reviews tailored to Enterprise Risk Assessment findings & Case Management Tool used

- Limited data sharing across organization / countries / departments

- Some screening and RMs react to client changes and triggers review between periodic reviews

PROACTIVE TO RISK

- Reviews triggered by AML / transaction monitoring / fraud systems; news events trigger targeted review automatically

- Global standards, with framework for exceptions and adequate equivalent controls

- Use of RegTech and dedicated tools / analytics; outputs partially integrated to rest of firm

- Detailed performance metrics and capacity projections for MI purposes

3
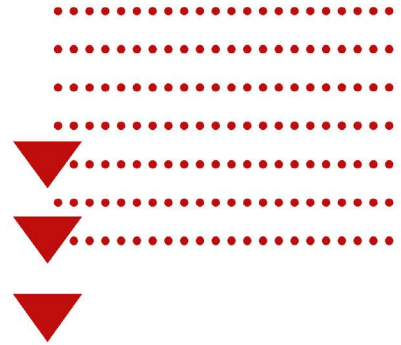
4

SERVICING THE CLIENT

- Complete case tracking and transparency of onboarding status

- Use of RegTech and dedicated tools / analytics; automated most stages & outputs integrated for majority STP

- Mature Data Strategy with available, right format and fresh data across firm / countries

- Digital self-service capability for clients, in order to perform KYC outreach

HOLISTIC KYC MANAGEMENT

5

- Collaborative and intelligence sharing common within the bank where possible

- Network view of client enabling prediction of changes in client's risk profile

- Less or no manual intervention to complete KYC review

- All clients experience frictionless services across business segments / countries / products

THE TOOLS & TECHNOLOGY TO UNLOCK PKYC

The tools required to build a pKYC architecture are either open source or inexpensive to buy or develop. Many of the languages used to develop these tools (e.g. Python, Java, and Apache) are already available in most financial institutions.

Several relevant external data sources can be relatively easily acquired. Company registries such as the UK Government's Companies House website are readily available, and APIs to capture this data can be inexpensively developed or procured. Banks already leverage a number of external paid data sources including credit rating data and wallet share information, which can also be linked using APIs. Internally, on top of linking institutional data storage systems and transaction data into one central data source, technology such as Optical Character Recognition (OCR) can be used to digitize relevant datapoints from paper documents, which prior to these technological advances were inaccessible to analytics projects. Data quality is a key consideration and having a set of internal and external data sources per attribute, ranked based on trust of data quality, is an important consideration.

Off-the-shelf graph database technologies can be leveraged to show a more intelligent and intuitive network view, capturing the interconnectivity of a client with its counterparties, products, transactions, and any data pulled internally or externally. Such technologies can assist KYC teams in understanding the intricate links between interconnected legal entities, such as consumers, suppliers and holding companies as well as associated individuals such as persons on the board and company directors. With RPA or workflow automation tools such as Airflow, initial triggers can be built to flag events which impact the client's risk threshold to compliance and other relevant workstreams. Over time, more sophisticated alert systems can be built such as flagging predicted risk as a resultant of events affecting parties connected to the central client, using event streaming and machine learning tools.

pKYC technologies available in the market, including Arachnys, Tresecta, Encompass and Quantexa look to leverage existing KYC systems and will likely not require a major overhaul of existing technology. Other banks are preferring to take this opportunity to upgrade their KYC infrastructure. Whichever route you might choose, Capco's experts can pave the way for you.

Figure 3:

An example architecture of a pKYC process
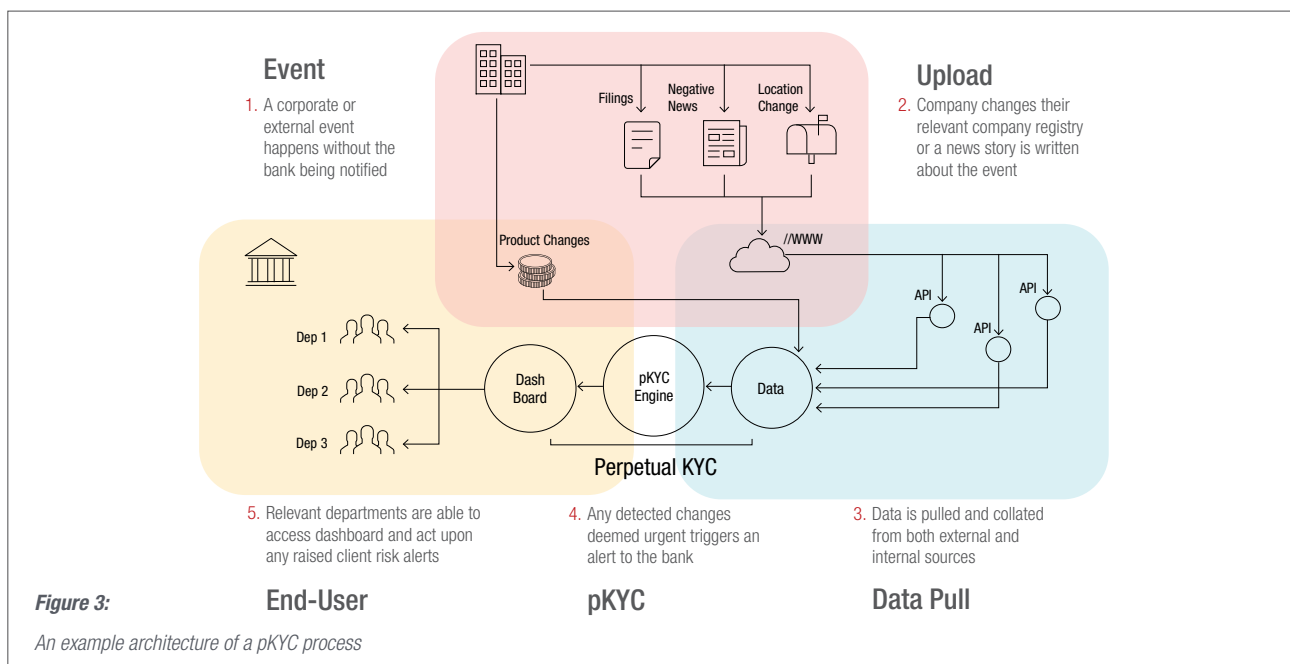
BENEFITS OF PKYC

Firms today continue to rely on highly manual and costly processes to complete KYC which is a key component required to meet AML regulatory requirements and manage reputational risk. However, it doesn't need to be this way, as the pKYC process can realize the following benefits:

Better risk management
A more effective monitoring system and the 'network view' reduces the chance of large fines from the regulator and reputational damage by missing what you 'should have known' about your clients. A better picture of what is 'normal' for each client also makes it easier to spot unusual activity.

Reduced cost
An optimized view of client risk both reduces the number of KYC refreshes required and ensures that risk levels can be monitored more automatically. Both these can substantially reduce the KYC resource cost by minimizing repetitive worker effort, avoiding errors, and targeting costly human resources to more complex cases for where a client's risk changes significantly.

Client-centric service
Better document management and an enriched view of client data means that clients are not subject to repeat requests for similar documents. As a result, the client lifetime value is increased as servicing becomes lower friction across the business, product areas and even jurisdictions.

Increased revenue
Product/relationship managers have the data required to cross-sell more effectively and seamlessly given the complete view of the client and similar peers. The client base can be grown more effectively by targeting clients within the network.

AS A FIRM, WHERE DO YOU START ON THE PKYC JOURNEY?

There are no silver bullet recommendations, but there are some good rules of thumb to get going:

1. **Define a candidate client group which is currently manually intensive to KYC so that automation can achieve the highest ROI and operational impact**; groups can be divided by legal entity type, business lines or geographies but needs to be well parameterized and clearly scoped

2. **Consider the KYC requirements and the availability and quality of data for the selected client group**; perhaps two client groups are equally manually intensive to KYC but only one has an API-ready online corporate register available against its client list; in which case, the group which has more data available would be the more effective place to start

3. **Plan the scaling of the solution carefully**; creating a minimum viable product for a high impact area and testing it thoroughly before scaling to other areas is essential. A pKYC solution needs to integrate a whole ecosystem of technology solutions and impacts operational guidelines – starting small, proving success and then scaling it out will maximise your chances of success

WHAT NEXT?

With the ever-increasing KYC costs and volumes in addition to constantly changing regulatory mandates, getting KYC right has become a question of business and operational viability.

pKYC is not a big leap into the unknown but a process which can realise iterative benefits along the way, wherever you are in the maturity curve.

The time for change is now. Connect with Capco to see how we can support you on your journey.

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ABOUT CAPCO

Capco is a global technology and management consultancy dedicated to the financial services industry. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward.

Through our collaborative and efficient approach, we help our clients successfully innovate, increase revenue, manage risk and regulatory change, reduce costs, and enhance controls. We specialize primarily in banking, capital markets, wealth and asset management and insurance. We also have an energy consulting practice in the US. We serve our clients from offices in leading financial centers across the Americas, Europe, and Asia Pacific.

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