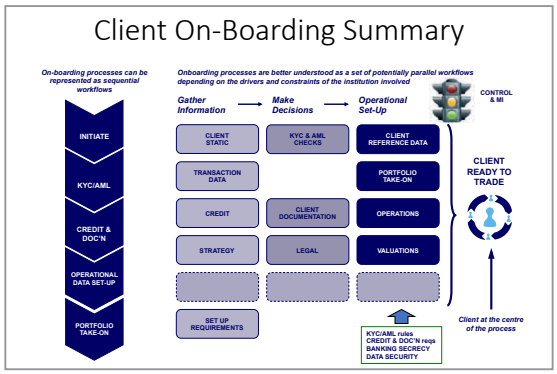
Operational & Technological Strategies to Streamline CLM and KYC Processes and Generate Efficiencies

LYSIS FINANCIAL

Contents

Executive Summary

Client Lifecycle Management (CLM) is the process of bringing new customers (or portfolios of customers) into a firm and then the subsequent relationship activities such as operational processes and on-going due diligence.



The purpose of this paper is to examine the CLM space in relation to new technology and innovations which have been developed in recent years. The paper focuses specifically on the over-arching CLM processes and the detailed Know Your Customer (KYC) processes which form part of that. Other areas of Client On-boarding (COB) and CLM such as credit, legal documentation and account opening are referenced, but not studied in detail.

Effectively managing the life cycle of a client relationship will improve customer experience and reduce the overall costs of maintaining relationships. These efficiencies of initial on-boarding might well be the difference between winning a deal or not.

In the last 10-15 years the financial services industry has tried a number of initiatives such as off-shoring and KYC utilities and yet the KYC and CLM process is still generally inefficient and costly. More recently a number of interesting technology plays have started to emerge and are getting a lot of attention.

In order to design and implement a successful KYC & CLM Target Operating Model there are a whole range of inter-linked considerations firms need to take into account.

This paper considers:

Operational Models:
- On-shore
- Off-shore
- Hub & Spoke
- Centralised
- Centres of Excellence

Resourcing:
- In-House
- Partner Companies
- KYC Utilities
- Hybrid Mode

Technology:
- CLM Platform
- Blockchain
- AI/Robotics
- Data Aggregation
- OCR

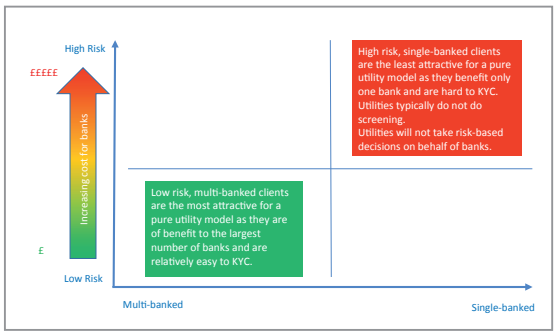
Governance:
- Global Operating Model
- Multi-party Processes
- Data Governance

Most firms now deploy a hybrid model for CLM and KYC being a combination of two or more of the models below:
- Model 1 – do it all in-house
- Model 2 – out-source some or all of the processing bi-laterally
- Model 3 – utilise data and services from KYC utilities as effectively as possible
- Model 4 – create regional utilities with similar banks to address client segments not covered by utilities.

This paper considers the factors involved in successfully implementing a successful CLM operating model.

The economics of KYC utilities are that, to reduce costs for customers, they need to build a KYC file once and then sell it multiple times.

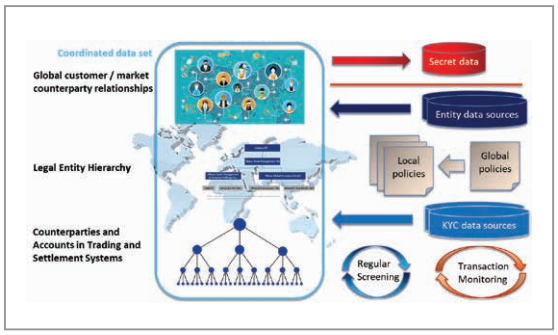
The larger multi-banked clients in many cases tend to be the lower risk, easier entities to KYC and a lot of the data is available publicly. The higher risk clients tend to be smaller,more private, harder to KYC ... and single-banked. Thus, the commodity the KYC utilities are most able to build only solves part of the problem their customers face.



If the 2000s was the decade of off-shoring and the mid-2010s the period of KYC utilities, the focus is now firmly shifting to technology and more effective data and process management.

A CLM architecture has competing requirements:

- Relationship data in the front office.
- Related customer legal entity data on which due diligence must be done.
- Related customer accounts in multiple systems.
- Data and banking secrecy rules.
- Global operating model and local jurisdictional requirements.



The process, systems and data architecture required to support a global financial services firm with its CLM requirements is complex and the global governance of such an architecture is difficult to get right.

In addition, increasingly complex regulations means that most financial services firms are seeing the speed of client on-boarding drop to painfully low rates and the productivity in their CLM teams decline dramatically. Processes such as data gathering, PEP, sanctions and bad press screening and enhanced due diligence are particularly slow.

The concluding parts of this paper examine some of the factors involved in the slow-down of these processes and the technology solutions that may reduce the burden.

LYSIS INNOVATIONS Lab

Lysis Financial operates a CLM and AML Innovations Labs from its London Operations Centre which has allowed the firm to carry out sandbox testing of real user cases and to develop process innovation relating to CLM and KYC.

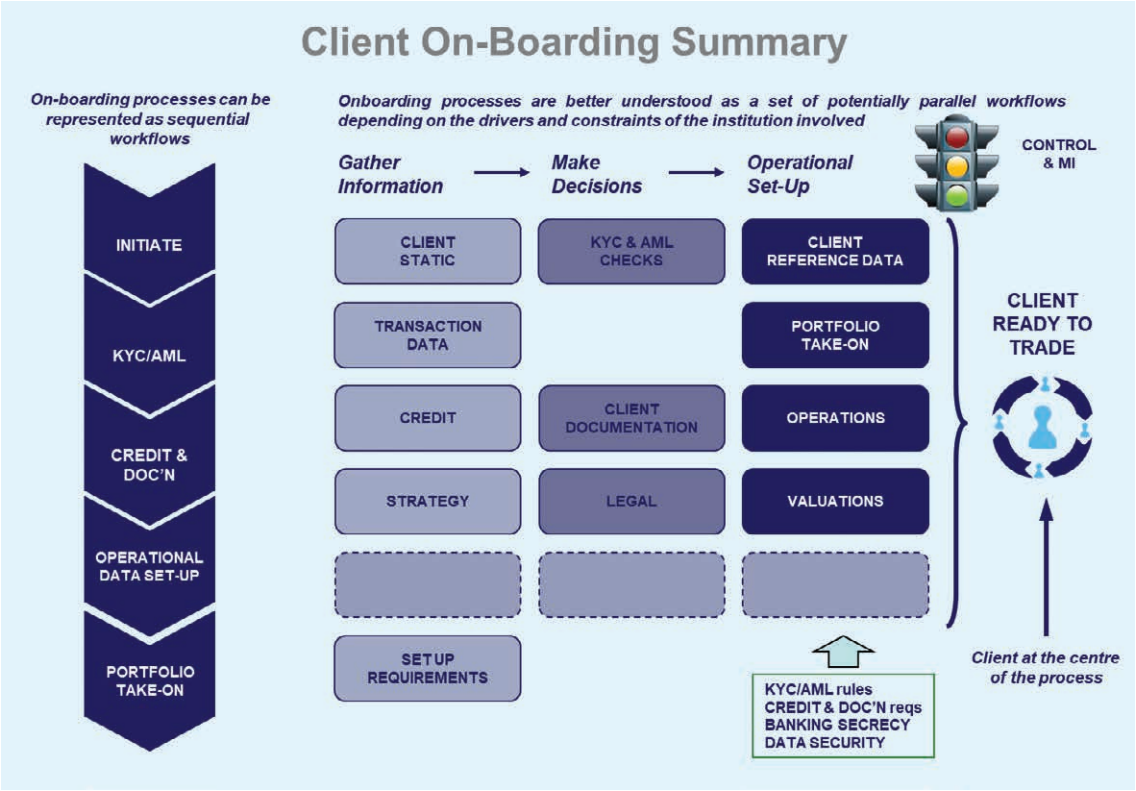
This research has played a key part in the development of this paper.

Introduction

Client On-Boarding (COB) is the process of due diligence and operational set up to bring new customers (or portfolio of customers) on to a firms books. It includes due diligence in areas such as Know Your Customer (KYC) and Credit and operational set-up such as Legal Documentation, Client Classification and Account Opening.

Client Lifecycle Management (CLM) includes COB and also the relationship activities, operational processes and due diligence involved in on-going work with the customer.

Client On-Boarding (COB) processes can be represented as sequential workflows. They are better understood as a set of potentially parallel workflows depending on the drivers and constraints of the institution involved:



CLM starts with COB and then some of the processes are re-visited during later phases of the relationship.

Challenges

There are several core themes for financial services firms and other regulated industries to consider in the CLM space at present.

Effectively managing the life cycle of a client relationship will reduce the overall costs of maintaining those relationships and the efficiency of initial on-boarding might be the difference between winning a deal or not. At each stage speed and efficiency must be balanced against effectively conforming to regulatory requirements. Regulatory KYC checks (including Sanctions, Enhanced Due Diligence, Screening, etc) are a costly but necessary processes all financial institutions and other regulated firms, such as Estate Agents and Law firms, need to deal with. KYC is a requirement which is often seen as a burden at the point of on-boarding, but is also an on-going requirement via Periodic Review cycles.

The regulatory burden has become far more aggressive over recent years with the industry witnessing huge fines which have been levied for regulatory failings relating directly to KYC and AML. This has really woken regulated firms up to the fact that KYC is no longer optional, and it is now the cost of doing business with the cost of failure becoming much more severe. With the increase in Deferred Prosecution Agreements (DPAs) being imposed by domestic and international regulators, the price of failure is far more burdensome and intrusive for a longer period of time.

Managing these regulatory hazards whilst still maintaining a positive experience for the client is now a major headache, not to mention cost, for the financial service firms and other regulated industries.

Due to the risks which KYC protects firms (and the industry as a whole) from, ensuring the correct level of controls and systems are in place to avoid regulatory breach has resulted in spiralling costs linked to KYC and CLM processes. KYC can be a very expensive and burdensome process – for both the provider and the client - which means firms now need to drive efficiencies if they are going to operate as successful and compliant businesses whilst still maintaining client focus.

As previously mentioned, the current model which the financial industry, along with other regulated industries follow is heavily reliant on people. This has led to a chronic shortage of skilled people in the market which has resulted in demand out-stripping supply. This equates to a negative impact on both quality and the cost of KYC reviews.

For this reason the future of KYC and CLM is moving towards solutions that are less reliant on individuals and more reliant on data sharing and technology. This leaves room for both the technological evolution and KYC utilities whilst maintaining the need for skilled professionals in a reduced capacity.

In an attempt to streamline and lower the costs associated with KYC, the financial services industry has looked at ways of centralising and improving the processing of KYC reviews and other CLM related requirements, as well as trying to share the client data necessary to complete the KYC checks given that many clients are multi-banked. However, the KYC Utility industry is yet to reach the point of success it was envisioned it would reach when it launched.

The KYC and CLM process is still generally inefficient and costly.

A Focus on KYC Across Service Industries

KYC is a core regulatory requirement for all regulated firms in most global markets. Historically this has generally been considered a burden within the financial service industry, with other industries playing catch-up recently. The UK Money Laundering Regulations 2017 ("MLR17"), and the EU 4th Money Laundering Directive ("4MLD") are far more prescriptive with regards to regulatory requirements and place a new regulatory burden on estate agents and other industries in relation to AML and KYC. Firms need to constantly maintain compliance with these regulations which involves constant review and monitoring of their clients and counterparts.

The financial services industry has a far greater experience of dealing with the challenges relating to KYC than other industries where the regulators have only more recently become engaged on AML, e.g. the property services industry. However, the fact remains that in most cases, financial institutions are yet to find a way to carry-out KYC reviews and maintain an effective CLM process to meet the regulatory requirements in a time and cost-efficient manner.

The key stages within the CLM and KYC life-cycle include:

- Initiation
- Due Diligence
- Client Out-Reach
- Screening
- Quality Assurance
- On-Going Monitoring & Review
- Client Off-Boarding

Each of these stages of the KYC and CLM processes contain essential controls which an institution needs to manage from a risk perspective. These controls are usually manual and rely on teams of professionals to manage the KYC review and documentation aggregation processes. Automated monitoring, relating to sanction and payment screening, only kicks in once the client has been onboarded and the KYC review is complete. There is also still a large amount of human effort required in relation to the on-going monitoring process.

With the dawn of Challenger Banks and other means of banking becoming a reality, financial institutions and other regulated industries need to consider technology which is being developed and adopt it in a way which will fit into the troublesome processes of KYC and CLM in order to speed up the client onboarding process from a client relationship perspective as well as reducing overall costs if they are to maintain their market share.

This is not to say that KYC utilities and also manual processing are no longer part of the solution, but firms will need to consider a hybrid approach if the KYC conundrum is to be solved. Technical advances mean this hybrid approach will need to rely more heavily on new technology.

Innovation & Sandboxing

There has been a lot of development recently in relation to innovation within the AML and CLM industry and some of the technology advances are now sufficiently mature enough to trial and potentially adopt. Due to the regulatory and legal confines relating to data, the majority of testing has been carried out in sandbox environments on anonymised client data. This has allowed firms to develop and innovate processes.

Lysis Financial operates AML and CLM Innovations Labs from its London Operations Centre which has allowed the firm to carry out sandbox testing of real use cases and to develop process innovation relating to KYC. This research has played a key part in the development of this paper.

Operational Objectives for CLM and AML Operations

Whilst the regulations governing KYC are generally consistent in the UK and equivalent jurisdictions, the way different institutions interpret and apply these requirements differ. However, there are clear operational objectives which are common to all firms that must undertake KYC and mange CLM processes:

- Reduce the time and cost it takes to onboard a new client
- Reduce the interaction and burden which is placed on the client
- Ensure the process is robust and controlled
- Ensure regulatory requirements are met

Avoid Financial Penalties and Regulatory Censure

Avoiding regulatory scrutiny and in turn avoiding financial penalties and reputational issues is an objective that all firms share. The likelihood of a financial institution spending the vast amounts of time and effort, and of course cost, required to carry out KYC reviews just to protect itself is highly unlikely.

This isn't to say that firms would not carry out due diligence on perspective clients as well as monitoring existing ones if they did not have to. But it is highly unlikely that a firm would burden itself with such complex and costly requirements were there not the levels of regulatory scrutiny we have today.

Cost Reduction and Operational Efficiency

Another operational objective all institutions share is a desire to lower the cost of KYC.

The cost of KYC at the point of onboarding can run up to multiple thousands or even tens of thousands when dealing with non-simplified due diligence relating to medium and higher risk clients. The onboarding of these entities does not only carry significant cost but can also take weeks if not months to complete – potentially souring a newly established client relationship. Having an inefficient process when dealing with periodic reviews could result in having to contact an existing client multiple times to obtain KYC related documents through the lifecycle of the relationship.

Driving efficiencies when dealing with KYC will not only lower the cost related to KYC but will also significantly improve the client experience and the on-going CLM.

Operational Strategies

There have been a lot of developments within the KYC and CLM space in recent years. The global nature of the processes related to CLM and KYC, the advent of the utility industry, off-shore/on-shore models and the ever-escalating costs has given firms a lot to consider. This section covers some of the considerations and approaches firms should consider when reviewing or building a KYC and CLM Target Operating Model.

Operational Models

Given that the majority of FIs are globally focused and located, it is often difficult to have one jurisdiction to process and manage all KYC and CLM requirements. This is due not only to global time zones, but also the diverse local jurisdictional requirements which can differ across different regulatory regimes. In some cases, data protection and banking secrecy laws also add to the complexity of requirements. Firms need to consider different operational models which take account of the global nature of their businesses as well as the geographical spread of their clients and their operations.

Local Jurisdiction Model

Under the local jurisdiction model, a firm spreads its KYC and CLM operations across its entire geographical footprint. Teams service the KYC and CLM requirements locally for their businesses. Whilst this provides a good level of direct support to the business on the ground, it is not the most cost-efficient way to manage the CLM & KYC requirements and can lead to very inefficient data management such as duplication of effort and documentation.

KYC analysts and operational management in the global financial hubs, such as London, New York and Hong Kong, come at a premium and firms face the financial challenges of local market forces as well as attrition of good performers being attracted to join competitor firms. Equally, in the smaller locations it might be difficult to find enough people with the right skills to ensure, particularly, the KYC requirements are met correctly.

Whilst being aware of and meeting any local jurisdictional requirements, most firms also have a target to centralise and re-use internally as much data as possible given that 80-90% of the KYC requirements across the major financial centres are the same. This is more difficult when the data and processing is spread across the globe. Implementation of a good CLM/KYC workflow tool that facilitates data sharing globally and is driven off a common global policy with local uplifts will go a long way to solving this issue.

Hub & Spoke Model

The hub and spoke model has been used by many financial institutions and has proven to be a successful operational model for the purposes of KYC and CLM. Under this model, there are smaller regional KYC and CLM operations supported and managed by a central team at a central location. This model allows the centralised hub to instill consistency and quality within the regional operations and also facilitates usage of a global workflow tool and shared document stores.

This model works particularly well in Europe and the US due to the comparatively close geographies from the centralised hub to the regional teams. This allow management and SMEs to be able to travel with ease without having the burden of long-haul flights or dramatic changes in local time zones. Hub and spoke models can work in AsiaPac, but often the spokes are quite independent.

Some Hub and Spoke models are backed up by large "centre-of-excellence" operations based in one or more low-cost jurisdictions who can absorb the high volume and low risk simplified and standard due diligence cases. In this model the front-office facing and also the high risk components are often based locally.

Location

Currently the majority of cost relating to KYC is personnel cost and is directly linked to location and expertise.

Traditionally the majority of KYC expertise has been located in global financial centres such as London, New York and Hong Kong. However, with the pool of experienced personnel being a shifting commodity, market demands stretch day rates and salaries for KYC analysts so many firms have tried to implement other location strategies to reduce the cost of KYC.

Off-shoring KYC operations to low cost jurisdictions has been a feature of the market since more rigorous KYC requirements came into force after 9/11. Unfortunately this has often been done in an entirely cost-focussed, hurried manner which has resulted in many off-shore functions being brought back on-shore as the effectiveness of the low cost operations did not meet requirements. KYC and CLM are complex regulation and knowledge-intensive roles and a structured and measured approach is required to build up and maintain teams who can work consistently.

More recently, in an attempt to reduce costs but maintain quality, many financial institutions have started to establish KYC processing centres in lower cost local areas such as the North East of England and Belfast in the UK, and Delaware in the USA. The success of these initiatives has been mixed as the local workforce often do not have the experience or the industry knowledge that personnel in major financial hubs do. Again, the key to making this work is a structured and measured approach to set-up and on-going personnel development.

By taking pragmatic steps and investing in training, processes and technology, moving KYC operations to local low cost centres, or even low cost jurisdictions can be successful given sufficient time and investment. To train a person with no prior KYC experience or knowledge to be able to process low risk/simplified due diligence (SDD) files successfully will realistically take 3-6 months. To take that person from processing SDD files to successfully carrying out enhanced due diligence (EDD) or quality assurance (QA) of reviews will typically take 2-3 years.

Training and staff development

If a financial institution is considering moving its KYC operations to a lower cost centre, establishing a long-term relationship with a company that is able to provide expert, bespoke KYC training is essential. Whilst on-line training has its benefits, successfully establishing a new lower-cost operation will typically involve face-to-face training of small cohorts of analysts in both theoretical and practical workshops. This will give the analysts foundations to build an understanding of both the regulatory and operational requirements relating to KYC.

Finally, any new KYC operation needs to be seeded gently over time, with manageable volumes of individuals introduced at any time – this will allow operational understanding to be developed as well as allowing deployed SMEs to support the operation over a period of time until senior management and the business are sufficiently skilled and confident of its ability.

Off-Shoring

A specific location strategy is off-shoring. Off-shoring of KYC operations was seen to hit its peak in the early 2000s, with teams totalling thousands of analysts being recruited in locations throughout India and other jurisdictions. However, these early off-shoring strategies did not always work as was envisaged as the amount of training and planning required to make these teams successful was not always applied. This resulted in many firms bringing the off-shore processing back to the headquarter location of that institution – this again affected efficiency and also cost.

In recent years there has been a rejuvenation of off-shoring within many tier 1 and tier 2 financial institutions – the main driver being cost. However, lessons have been learned and these firms who are off-shoring the KYC and CLM operations are being far more cautious in terms of adopting sensible set-up timeframes and allowing the off-shore teams sufficient time to build up experience processing less complex cases before asking them to process the more complex cases.

Many firms are retaining the higher risk, EDD processing of KYC reviews and client onboarding within their on-shore jurisdictions, with the lower risk and more vanilla clients being processed off-shore. Secondly, the establishment of the new off-shore functions is more often than not being carefully planned with teams being trained and seeded with smaller cohorts of analysts at a time. Training has been more rigorous and bespoke with SMEs being retained within the off-shore centre for long periods of time to provide the support and guidance required for the operation and processing to be successful.

Partners

A comprehensive KYC model nowadays will typically involve use of partners in various capacities from data sourcing through to surge resourcing.

The operations, process, technical and data architecture will need to support processing across internal and external entities and across multiple jurisdictions and allow for partners to be swapped in and out as requirements dictate.

Hybrid Model

Most banks will deploy a combination of two or more of the models below:

- Model 1 – do it all in-house
- Model 2 – out-source some or all of the processing bi-laterally
- Model 3 – utilise data and services from KYC utilities as effectively as possible
- Model 4 – create regional utilities[1] with similar banks to address client segments not covered by utilities.

[1] At the time of writing the authors are aware of regional utilities being under discussion or development in Germany, South Africa and the Nordics.

KYC Utilities

Jon Sweet, CEO of the Lysis group of companies, was quoted in the Financial Times in 2013 saying that "over the next three to five years many banks will adopt some form of hybrid model for carrying out KYC and CIP (Customer Identification Programme) checks on their financial and corporate customer bases". This hybrid model was envisioned as some combination of in-house processing (on-shore and off-shore), outsourcing and KYC utilities. In other words, a hybrid of the four models above.

The majority of financial institutions face a number of core challenges when it comes to processing KYC and managing CLM requirements. Central to these are primarily challenges of cost and efficiency. Challenges relating to cost are not only linked to expensive personnel but also the cost of housing, often large, teams of KYC processing personnel and the related infrastructure and management oversight. Inefficiencies within a firm's KYC operation will inflate this cost with a lot of time spent sourcing and collating publicly available documentation.

Banks are therefore interested in ways in which they can pool resources to reduce the costs associated with each of them doing KYC on the same customers. This and the hope that specialist firms would find ways to radically improve the efficiency of CLM and KYC led to the dawn of the KYC utility industry.

The majority of KYC utilities launched with the intention of collecting KYC data for each legal entity and then selling it to the financial institutions ("FIs") that need it. This is beginning to work in relation to multi-banked customers. However, most financial institutions are able to absorb the cost and effort of dealing with the high-volume KYC requirements for low risk, multi-banked entities – the main focus of the utility model. It is the higher risk, often single-banked entities that cause the most KYC issues.

Both financial institutions and KYC Utilities continue to struggle with the single banked high-risk clients. In many ways, the industry has not developed in relation to these requirements.

Analysis of KYC Utilities – Bank Take-Up

When KYC utilities came to the forefront of the financial service industry's consciousness in 2014, the expectation in the market was high with most of the global banks having a serious conversation about using a utility for at least some of their KYC processing. The utility sector was expected to solve the issues relating to KYC as client data could be reused across banks – i.e. resold to the companies that used the utility service. Take up of utilities has been slower than hoped, both by buy-side firms who have not put as much data into the utilities as expected and by sell-side firms who are finding that the data they can get from utilities is currently more limited than they had hoped.
Utilities were launched on the basis of using a single KYC policy which the FIs using the service would all conform to and adopt. However, as different firms have different risk appetites and client types, and they also interpret the regulations which govern KYC differently, the generic approach the utilities initially took would not work. This led to multiple carve-outs and additional requirements from the centralised policy which made it impossible to resell a completed KYC pack across multiple banks.

Due to the increasing number of firm-specific requirements, the staff who were processing the KYC were becoming confused in regard to which policy and requirements they were working to. The quality of the output from some utilities was then called into question which led to firms losing faith in the ability of the utilities to meet their requirements. Utilities probably remain a valuable source of data for some customer-types, but it seems unlikely they will be the complete answer to any bank's KYC requirements.

Analysis of KYC Utilities – The Economic Quandary

Banks' Perspective

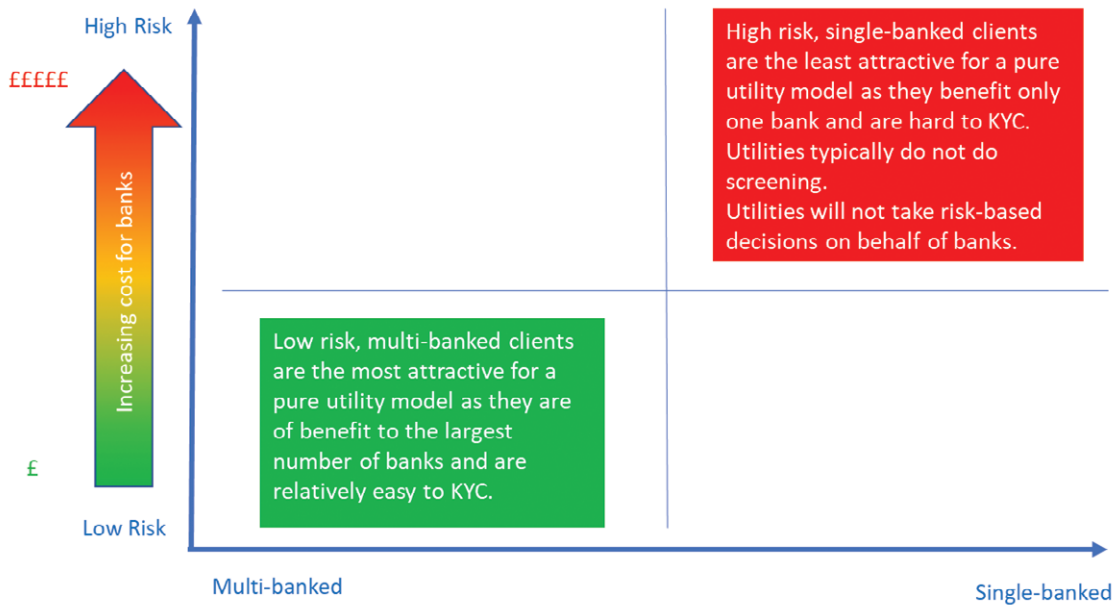
The main reason a firm would adopt a utility service would be to increase efficiency and reduce operational cost. However, as KYC is heavily reliant on skilled personnel, the utilities had to invest a lot in training up recruits in low cost centres, which impacted their scalability and therefore their profit. In effect they have had the same scale-up problems as the banks.

Equally, firms considering using the utility had to invest a lot of time in undertaking lengthy proof of concepts (POCs) to test and gain comfort from the service. Quite a lot of POCs failed or pointed to a much-reduced solution, resulting in a lot of time, money and effort being spent by both sides with potentially no real outcome.

The firms which have taken up a utility service have typically been able to remove some of the operational cost relating to KYC, but have had to establish additional QA processes to review and test the output of the utility. This has often replaced cheaper KYC processing headcount with an additional and more expensive QA process.

Utilities' Perspective

The economics from the utilities' perspective is that, for their model to work in a way that reduces costs for their customers they need to be able to build a KYC file for a legal entity once and then re-sell it to multiple customers. Unfortunately, as the diagram below shows, the larger multi-banked firms in many cases tend to be the lower risk, easier entities to KYC and a lot of the data is available publicly. The higher risk firms tend to be smaller, more private, harder to KYC … and single-banked. Thus, the commodity KYC files that the KYC utilities are most able to build are also the ones that cause financial institutions the least problems.



Utilities – Logistical Challenges

Whilst the concept behind a KYC utility makes perfect sense – i.e. many FIs service a lot of the same clients which potentially results in a lot of shared data which can be resold - the sector has faced a lot of logistical challenges which impact its development and ultimately its initial success.

One fundamental issue was the inability to convince multiple FIs to use the same policy which rendered an inability to be able to scale and meet the demands which the market expected. The fact that waivers and carve outs where required, resulted in KYC analysts redoing the exact same legal entity multiple times but in slightly different ways each time.

The second fundamental issue was the economic quandary described above.

Another issue which the utility sector had difficulty in overcoming was training up inexperienced analysts in low cost locations to be able to deal with the high risk/EDD clients which financial institutions deal with. In reality it takes at least 18 months for a talented new analyst to be able to successfully complete medium and high risk reviews, with 2-3 years being a more commonly accepted and accurate timeframe. Many banks have between 10,000 – 100,000 people processing KYC globally. However, the utilities are still building capacity but remain low in the 1,000s in total.

Additionally, with EDD cases it is frequently necessary to reach out to the end-customer to gather information that is not available publicly. The workflow needed to control this across customer-facing staff, internal compliance staff and a utility has proved difficult to get right in most cases as end-clients were not confident enough to send non-public information to a third-party.

A final major issue the KYC utilities struggled with was carrying out an operational process which ultimately is the responsibility of the Money Laundering Reporting Officer ("MLRO") who typically sits within the compliance function and who is personally liable for KYC failings. The challenge of an Operations Manager being mandated to reduce cost whilst an MLRO demands quality is an age old issue for financial institutions and has created a lot of headaches for the utilities.

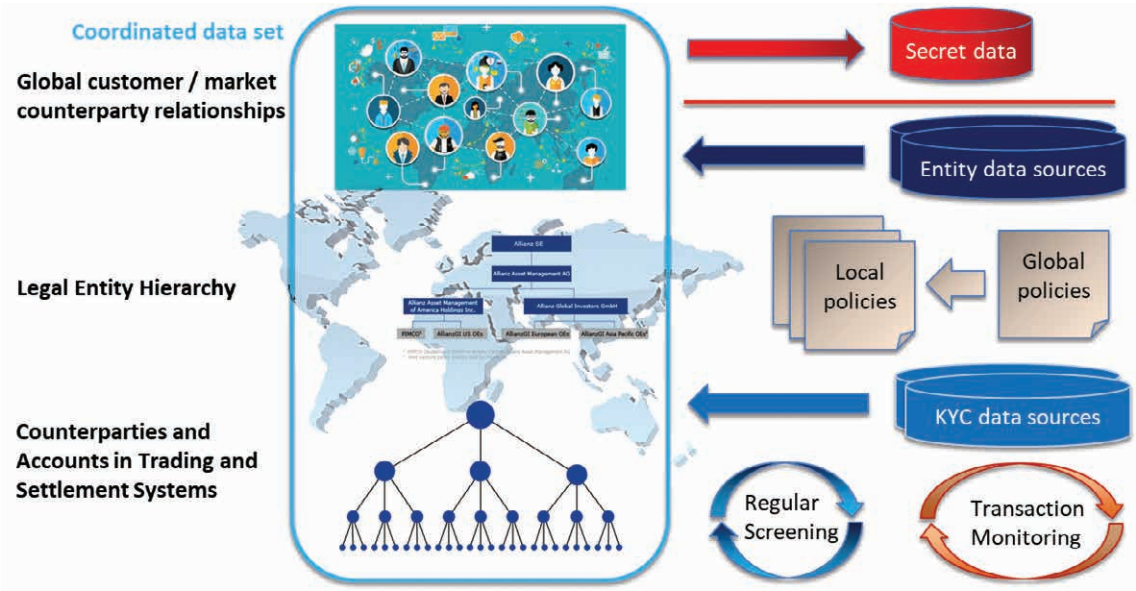
Technology

If the 2000s was the decade of off-shoring and the mid-2010s the period of KYC utilities, the focus is now firmly shifting to technology and more effective data and process management.

Architecting the solution

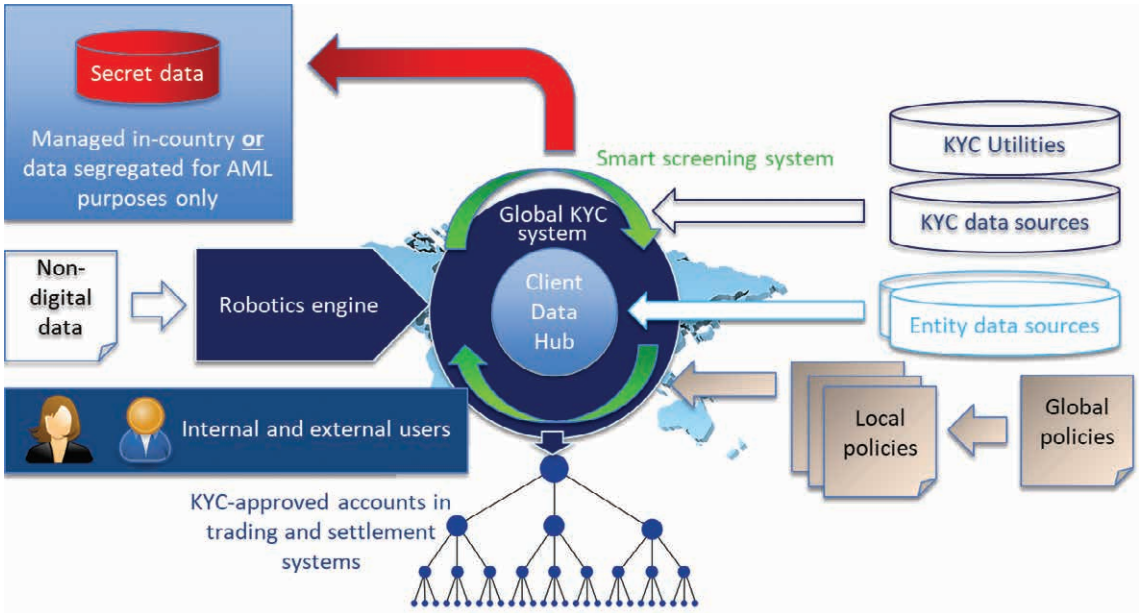
A typical COB/CLM architecture has to deal with a number of (often competing) requirements:

- The front office requires data focused on relationships and the methods by which business is conducted.
- Each of the front office relationships is with an individual or team representing a customer legal entity and the CLM data architecture must be able to link the relationship to the customer legal entity so that due diligence can be performed and contracts executed.
- Each customer legal entity will potentially be doing several different types of business with the firm which usually requires customer accounts to be set up in multiple trading and settlement systems.
- Some of the data held will be subject to jurisdictional secrecy rules.
- If the firm is operating globally, where required it must consider meeting local due diligence requirements of the jurisdictions.
- For reasons of efficiency the firm is likely to wish to perform due diligence using a standardised operating model and sharing as much data as possible.
- There will often be a global KYC policy with local add-ons.
- The firm must perform regular re-screening and periodic review on its customers.
- The firm must monitor all transactions through its books for sanctions violations and AML and Counter-Terrorist Financing (CTF) breaches.



Key features of a workable solution are:

- A central client data hub containing mapping from CRM to legal entity to trading counterparty and fed by a credible external source of legal entity data.
- A global KYC policy (minimum standard) with local uplifts to cater for each jurisdiction.
- A global KYC system which controls the application of global and local policies and maximises re-use of KYC data within the confines of jurisdictional secrecy requirements.
- Efficient consumption of as much good quality external KYC data as is available from utilities and other data providers.
- Robotics and/or Artificial Intelligence (AI) engines that reduce the time spent consuming non-digital data.
- Self-service data-gathering for some customer types.
- A smart screening system that uses robotics and/or AI to minimise the time spent screening customers, filtering false positives, etc.
- APIs to downstream systems to ensure that there is integrity between open accounts and the possession of valid KYC.



This is covered in more details in Lysis' separate white paper on Technology and Data Architectures for CLM.

Identifying CLM Technology

Having a CLM process which is underpinned by an effective CLM workflow platform that suits the requirements of a firm's specific business is key if efficiency and transparency is to be achieved. In the past, many firms have opted for platforms which have been heavily used by their peers in order to satisfy the regulator that the CLM system is fit for purpose. However, a lot more software firms have introduced platforms to market which offer various degrees of functionality which can be better tailored to specific business and operational requirements. As such firms have more choice and more options relating to CLM technology than they previously had.

Smarter Technology

Since 2013 technology relating to KYC has come a long way, but despite all the talk of FinTech and RegTech in the industry, the overall impact of this on the current methodology of dealing with KYC has so far been low.

Optical Character Recognition (OCR)

KYC is an area considered to have a lot of promise from a technology perspective. Optical Character Recognition (OCR) technology has come a long way as a concept and as is rapidly entering the mainstream of KYC processing to deal with non-digital data. OCR is likely to play a big part in digitising the KYC related documents for high risk, off-shore legal entities which are generally in PDF or paper format. Taking this a step further, software firms are developing Bots which scan for KYC-related data from a large document such as a fund prospectus.

Natural Language Programming (NLP)

The area of KYC which causes a lot of difficulty is Enhanced Due Diligence and adverse media searches. Both of these processes are historically labour intensive and rely heavily on manual processing and decision making by experienced, and in turn expensive analysts, which results in huge additional costs to the processing of high risk KYC files.

However, Natural Language Processing (NLP) technology is rapidly evolving and is showing real signs of having huge operational benefits, as it can learn and automate manual processes and decision making which form part of EDD sanction, PEP and adverse media searches. Whilst NLP has the real possibility of removing the manual process of discounting alerts during EDD searches, it will take a forward thinking MLRO, plus confidence in the technology from the regulator, before NLP becomes a significant reality within the KYC space.

Data Aggregation

On the flip side, one area of technology which can already play a huge part in reducing the cost and time needed to process KYC is now a reality. There are a number of technology firms who have brought automated data aggregation to the market. These data aggregators effectively go out to pre-approved web-based sources (in line with bespoke policies) such as company registers, regulator sites and utility data sources, and replaces the need for an analyst to manually search the internet for publicly available KYC information. This information is then automatically aggregated and all relevant controllers and related legal entities are automatically screened for sanctions, PEP checks and adverse news.

To this end, the reality of automating the processing of SDD and low risk clients has already arrived. However, firms would still need a manual QA process to ensure the KYC is correct – this could still be carried out by a utility or (more likely) in-house.

Artificial Intelligence

AI is an area of new technology which is starting to develop and which will have a big impact on the way KYC and CLM processes are carried out and maintained.

There are already platforms available which scrape the internet, based on specific policy and procedural requirements, and aggregate the KYC documentation into a single KYC pack. As well as obtaining all the specific data, these platforms also screen all identified legal entities and controllers for adverse media, sanctions and PEPs and even discount any false positives. However, the real impact from AI will come from the ability to learn processes in the same way humans can, but with the consistency that firms needs to ensure conformity to carrying out KYC, especially EDD.

Blockchain

A lot has been mooted in relation to Blockchain and KYC over recent years, however the reality has seen very little impact on the majority of KYC processing. Whilst many institutions appear to see a future where NLP and OCR will have on impact on reducing the cost and manual processes relating to KYC, the view on Blockchain is currently less clear.

Whilst a Blockchain-based centralised KYC database may in theory work by using encryption, the SWIFT registry which has been in place since 2014 and is used by over 2000 financial institutions globally and does not utilise Blockchain. This may be due to concerns about validating the data and ensuring it meets individual policy requirements.

Another issue which is holding the use of Blockchain for KYC is the fact that many, if not most, financial institutions lack of internal capabilities and infrastructure to use Blockchain. Most of the major financial institutions rely heavily on legacy infrastructure which is unable to be adapted for emerging technology.

The smarter, more technologically focused Challenger Banks will probably have more success in using Blockchain for KYC requirements for their retail business than larger wholesale banks. However, until the regulators start showing a greater understanding and confidence in Blockchain for KYC, the majority of the institutions are more than likely to see how technology and opinion evolves over the coming years rather than stepping into the dark alone.

Despite the above slightly pessimistic summary, Lysis is of the view that blockchain could have a major role to play in KYC in the future. This is the subject of a separate whitepaper entitled "Digital Ledger Technology - An Emerging Consensus on the Buy-Side". The whitepaper is backed by a number of leading companies including Microsoft, JP Morgan Asset Management and M&G Investments and Lysis has contributed to the paper regarding how Digital Ledger Technology (DLT) can assist with AML controls.

Lysis Innovations Lab

Data

Client Data

Client data is a core requirement and key part of any operational model and strategy when it comes to KYC and CLM. The number of client data firms has increased dramatically over recent years as has the quality and accuracy of the information. Where, in the past, reliable client data was generally only available from UK or equivalent jurisdictions, the availability of reliable sources of client data is now spread across far more jurisdictions with good data being available from medium, and in some cases, high risk jurisdictions.

The limitations of these data providers and sources is that they are generally limited to conventional corporate legal entities and generally do not have accurate information on off-shore and other complex corporate entities and structures. To this end, 3rd-party client data has a big role to play in SDD and GDD requirements but is very limited in regards to high risk/EDD client types and processes.

However, if client data and information is accurately maintained throughout the CLM lifecycle, then the reuse of this initial and remediated data will remove the need of going to the client multiple times throughout the duration of the relationship.

Data & Banking Secrecy

Data and Banking Secrecy rules are an additional requirement that firms need to consider when planning their KYC and CLM target operating model. Firms need to be aware of which data they can share across borders and to whom and what restrictions there are on the use of that data.

Whilst most of the larger financial institution have invested quite heavily in systems to manage KYC and AML data, many of the smaller institutions still rely on paper files and spreadsheets. The result is inefficient processes, sub-standard record keeping and a failure to perform tasks such as regular screening in an effective and/or timely manner. Many of the larger firms are now finding that they need to reinvest in KYC systems in order to improve efficiency and manage KYC data globally. It is essential that local banking secrecy and data security laws must be considered.

With GDPR coming into effect in May 2018 firms that have Business-to-Customer relationships really need to clarify their requirements around client data.

Governance, Policy and Processes

Policy Efficiency

Key to any KYC and CLM process is the AML policy which dictates the approach the firm takes to AML risks and controls which mitigate these risks. However, many firms implement a policy which is not workable from an operational perspective and is often too far removed from the business the institution undertakes. To this regard, a policy should be regularly reviewed by all stakeholders to ensure it is still relevant and in-line with the business and associated risks, as well as still conforming to regulatory requirements.

Effective Change Management & Impact Assessment

If firms are to establish an efficient and effective KYC and CLM model, regular reviews of the entire process should be undertaken to identify inefficiencies and other legacy operational processes which may be superfluous to current requirements. Operational managers should work closely with compliance and business heads in order to identify and define new operating strategies. Some firms have introduced "hot houses" where key stakeholders and managers attend workshops where the terms of reference dictate the meetings will not end until a key requirement has been agreed – this opens up an environment for negotiation and partnership, rather than one party digging their heals in.

Once new strategies and approaches have been identified, there needs to an effective change management and impact assessment process before any new requirements, policies or procedures are introduced. A prudent firm would take their time in implementing change rather than rushing in order to close out a perceived risk.

Many firms are currently locked in a downward spiral of decisions made independently by departments without considering the impact on other areas of the firm that compromises efficiencies across entire CLM operating models. Senior business and operations management must be closely involved in all decisions that will impact the efficiency and effectiveness of the CLM operating model. It is those senior managers who will be held accountable by the regulator if the due diligence processes become so inefficient they grind to a halt.

Process Management – Target Operating Models

For a Senior Manager to be able to confidently attest to the fact that their area of responsibility is controlled effectively and complies with relevant requirements and standards of the regulatory system they need to be able to demonstrate that they understand the processes and controls within the areas they are responsible for.

When a financial institution relies on a utility, a range of processes for which a Senior Manager is ultimately responsible will be executed by third-party firms of which the Senior Manager is a customer rather than an Executive Manager. The Senior Manager will need to demonstrate that the processes executed by the third-party are understood and the interfaces and controls between financial institution and third-party are effective.

Governance

Arguably KYC managers in the UK have been helped by the introduction of the Senior Managers & Certification Regime ("SMCR"). The SMCR was introduced by the FCA in March 2016 in order to increase accountability within the financial service industry following the banking crisis of 2008.

The SMCR requires robust and well-evidenced governance frameworks including clear articulation of legal entity-level committee structures and their respective roles and responsibilities. In contrast to global governance, SMCR views management responsibility and accountability in terms of legal entity governance, but most global banking businesses are managed as global business lines rather than on legal entity lines. This creates a conflict which must be overcome.

However, KYC rules in most major jurisdictions are similar (despite what some in local compliance might say). Firms need to implement a global minimum standard with local uplifts. Therefore, good governance must control a global process across multiple high and low-cost locations. Senior managers responsible for UK activities face being found personally liable for failings relating to KYC controls.

Conclusion

It is evident that there is a lot for firms to consider when designing a KYC & CLM Target Operating Model. The struggle is always going to come down to compliance, cost and efficiency. These issues are going to be underpinned by the resource, systems and locations which firms need to consider when dealing with the complexities of KYC and CLM processes. Couple these two factors with the internal forces of business requirements, operational processes and regulatory controls then the complexities surrounding the operational design become amplified even more.

In order to design and implement a successful KYC & CLM Target Operating Model there are a whole range of inter-linked considerations firms need to take into account:

1. Operational Models:
    a. On-shore
    b. Off-shore
    c. Hub & Spoke Model.

2. How:
    a. In-House
    b. Partner Companies
    c. KYC Utilities
    d. Hybrid Model.

3. With what:
    a. CLM Platform
    b. New Technology
    c. Legacy Systems.

4. Internal & External Requirements:
    a. Risk Appetite
    b. Policy/Internal Approach
    c. Client Data
    d. Local regulations.

5. The future:
    a. Artificial Intelligence
    b. Automation
    c. Block Chain.

With all these different elements to consider, a successful KYC & CLM Operating Model will need to be well thought-out, supported by all internal stakeholders, and most importantly – implemented correctly.

How Lysis Can Help

Lysis Financial provides expert strategy definition, programme and change management, and project execution for senior governance, compliance, risk, operations and IT management within major investment banks, financial institutions and insurance companies.

We advise firms on the most effective operational strategy for executing AML/KYC/COB given the firm's geographical coverage and customer mix and develop Target Operating Models and Road-maps to achieve them.

We consider issues such as:

- Client out-reach models and client experience.
- Three lines of defence, internal organisation and reporting lines.
- AML Framework, Policies & Procedures
- Escalation models.
- Staffing levels and the optimum balance of experts versus more cost-effective personnel.
- In-house versus out-sourced, including KYC Utilities
- On-shore versus off-shore (and near-shore).
- Effective data management across the COB lifecycle.
- Banking Secrecy and Data Security requirements.
- Systems and workflow automation for both COB and KYC

Lysis Innovations Lab

The Lab is a testing and assessment ground for a range of AML initiatives including policy and process streamlining, improved Management Information (MI) solutions, new systems and new data sources. Successful initiatives are presented to our clients as potential ideas for efficiency improvements.

The Lab also enables us to enhance the services we offer, and provide to our clients by improving operational efficiencies and management information reporting.

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