KYC & AML Client Reviews

Increase efficiencies, to save time, money and effort

Non-compliance with Anti-Money Laundering (AML) and Know Your Customer (KYC) regulations continue to attract the biggest financial penalties in the market, with record-breaking fines being levied recently on some of the world's largest financial institutions.

In this paper, Joe Dunphy, Fenergo's VP Product Management, explores the role that KYC periodic reviews has to play in the levying of fines in this area and contends that the big problem with KYC is KYD (Know Your Data).

With one Fenergo client estimating it can take up to 60,000 interactive hours to complete the KYC review process, it is plain to see that the traditional approach of applying brute force to the problem is mired in operational inefficiencies and escalating costs.

Fenergo proposes a new approach to managing KYC periodic reviews.

Contents

©Fenergo 2015

1

Introduction

A Piecemeal, Cottage Industry of Entity Data Management

By Joe Dunphy, VP of Product Management, Fenergo.

Over the last five years, the financial services industry has been inundated with new rules and regulations designed to increase transparency and prevent another global financial crisis.These new rules – ranging from FATCA, GATCA and global OTC derivatives like Dodd-Frank, EMIR, MiFID II, Canadian and APAC derivative rules – have dominated industry news headlines and captured the attention of concerned compliance departments all over the world.

However, it's important to remember that it is Anti-Money Laundering (AML) and Know Your Customer (KYC) regulations that are still attracting the biggest fines in the industry. The last two years alone have accrued billions of dollars in financial penalties for financial institutions who were found to be non-compliant with AML and KYC regulations - regulations that have been around for decades. In other words, not one financial institution has been fined for breaching any of the new regulations which are currently dominating financial news. Worryingly still, with the planned enhancements of AML and KYC regulations (by FinCEN and 4th EU Money Laundering Directive), it is not hard to visualize the levying of even more financial penalties over the coming months and years.

The question arises - why are financial institutions flouting decades old regulations?

2

The Problem with KYC is KYD (Know Your Data)

AML and KYC regulations dictate that financial institutions must ensure that they know their customers and have verified their identities with appropriate data and documentation that proves that their clients are who they say they are, are not involved or related to anyone involved in money laundering or terrorist financing and don't represent an inordinate risk to the institution or financial system as a whole. Evidencing is important here.

> "The ultimate aim of the review process is to ensure continued compliance with existing AML and KYC compliance obligations supported by updated and refreshed data and documentation".

KYC and risk assessment is a normal part of the client onboarding process, culminating in the application of a risk rating or score. However, the process doesn't end here. Financial institutions are tasked with performing client due diligence on an ongoing basis throughout the lifetime of the client. This involves conducting periodic reviews of client data and documentation to ensure continued compliance with relevant regulatory obligations pertaining to the client. This review process will entail an aggregated risk assessment of the legal entity across all roles, types, relationships / associations (e.g. directors, shareholders and beneficial owners), jurisdictions, products and industry. A scheduled client review is dictated both by the risk assessment weighting (i.e. classification) and the date of the last scheduled review. The process should also be capable of supporting an event-triggered review, whereby any change in circumstance data that is materially significant may trigger a compliance review process.

The ultimate aim of this review process is to ensure continued compliance with existing AML and KYC compliance obligations supported by updated and refreshed data and documentation. In addition to maintaining a risk-based approach to AML and KYC compliance, periodic client reviews have the potential to close many of the compliance process gaps that may exist such as the absence or lack of data and documentation.

©Fenergo 2015

It also provides a regular mechanism for capturing change of circumstance data, which may bring the client into scope for other or newer regulations. The process itself instils confidence in the risk profiling of clients – reinforcing consistency of standards and enables auditability of the entire process. This process is also an excellent way to revisit data privacy issues across various jurisdictions and determine which of the newer regulations (such as FATCA, global OTC derivative rules etc.) pertain to clients based on their reviewed, refreshed and updated data and documentation.

3 Traditional Approach to Client Reviews Not Cutting It Anymore

The need to do client reviews is indisputable. However, the current approaches used to complete these are most definitely questionable.

The traditional response to client reviews has mainly constituted applying brute force to the problem, by throwing as many people and money at it to resolve it. However, this only ever succeeds in driving up the overall cost of compliance and is unsustainable given the sheer number of newly-introduced impending regulations that require (or will require) periodic client reviews.

> "For their 2,500 medium risk clients, it would take 60,000 interactive hours to complete the [KYC] review process."

Depending on the size of the institution, the number of clients and their risk classification (i.e. how many high, medium and low risk clients the institution has), the time and resources required to conduct a periodic review may be extensive.

Many financial institutions have found that as regulation has evolved and strengthened, their client and counterparty record keeping has not kept apace or their capacity to deploy periodic client reviews in compliance with existing regulations is greatly diminished due to resource constraints or focus on newer regulatory requirements. For institutions with a lot of high and medium risk clients, they may have to review thousands of clients (and thousands more pieces of data and documentation) in an effort to prove continued compliance with regulations.

To illustrate how resource-intensive this process can be, in the Use Case Examples section (on page 8), one of our clients estimated that they spent 24 hours of interactive time for every review. For their 2,500 medium risk clients, it would take 60,000 interactive hours to complete the review process (which is conducted on an annual basis). It is important to note that this calculation does not take into account additional elapsed time for review (i.e. the time it takes for clients to respond to the financial institution's request for additional or updated data and documentation).

With such an inefficient process, a new approach is badly needed.

©Fenergo 2015

A New Approach to Client Reviews

Some financial institutions are now moving away from a labor-intensive BPO-type arrangement and reviewing the process as a whole in an effort to introduce greater and more tangible efficiencies that save time, effort and money.

The scope of periodic client and counterparty reviews can be overwhelming involving thousands of clients and thousands upon thousands of data and documentation that needs to be reviewed. With clients being categorized by the size of risk they represent to the financial institution (high, medium or low risk), the ultimate goal will be to ensure that sufficient resources are assigned to the high risk clients, who require more frequent reviews and involve more complexity than their lower risk counterparts. To achieve this, resources will need to be freed from the other two risk categories.

Automation

Technology can play an important role in supporting the client review process and achieving quantifiable operational efficiencies without sacrificing compliance obligations. In our experience, we have found that financial institutions are willing to automate as much of the mundane work for the lower risk categories (medium and low risk), which make up the vast majority of the client numbers, and maintain high risk clients as a purely manually reviewed process.

So what do we mean when we say automate as much of the process as possible?

Of course, KYC client reviews will never be a purely automated task. However, there is considerable scope to automate a large number of manual sub-processes that create huge inefficiencies and delays as manual processes. Taking the Fenergo Client Lifecycle Management solution as an example, here's how Fenergo achieves these operational efficiencies.

"There is considerable scope to automate a large number of manual sub-processes that create huge inefficiencies and delays as manual processes."

- **Regulatory Rules Logic**

With Fenergo's Regulatory Rules Engine, financial institutions can remove much of the interpretation of regulatory obligations by applying rigorous rules logic to the client data. Even with the most basic data (e.g. legal entity type, role, jurisdiction, products and booking entity), the regulatory rules engine can determine if the client is still in scope for existing regulations or whether new regulations apply. Application of rules logic also enables the institution to identify all data and documentation required to support the regulatory compliance process.

- **Leveraging and Sourcing Data and Documentation**

A comprehensive client profile is critical to the bank's ability to measure the size of risk posed by the client. This is heavily dependent on the quality of client data and documentation available to the bank. KYC client reviews offer institutions the opportunity to map the data required against the data held. This process highlights the data gaps that may exist, prompting the KYC remediation expert to look for the data. By integrating a centralized entity data management solution to the compliance process, financial institutions can identify if they hold the artefacts required already (in other repositories across the bank) and determine if they can leverage and re-use this as part of the current KYC client review process. In our own experience of these projects, we have found that up to 80% of data and documentation during the client review process can be found internally within the institution, leaving only 20% to be collected from the client as a result of date expiry or simple refreshing. Alternatively, if the institution does not have the data, it can be sourced from the appropriate provider.

©Fenergo 2015

Fenergo's Client Lifecycle Management solution includes APIs to leading data providers like:

- ## Risk Score Calculation

The ability to automatically calculate a risk score based on the review process (either through the addition of new data, documentation or application of new regulatory rules) is critical to eliminating the threat of human error or misjudgement. Risk scores should be automatically compared to previous risk scores to determine the delta between the two, providing a fully auditable process of any change in risk score, weighting or attributed data and documentation.

- ## Optimized Workflow Processes

A fully streamlined workflow solution should underpin every client review process in an effort to achieve true efficiencies in current and any future KYC reviews.

©Fenergo 2015

5 Client Review Outcomes

There are a number of different outcomes that can be generated as a result of an optimized client review process. These are outlined below.

Client / counterparty data may need to be provided or updated

The KYC client review may highlight data and documentation that are missing, newly required or require updating (e.g. expired documentation). However, the data / documentation collection process can very often consume a lot of the time for the client reviews to be completed. As outlined above, a centralized client and counterparty data management solution can help the institution to leverage existing data and documentation to re-use during the KYC client review process, saving the time, effort and inconvenience involved in asking clients to resubmit this content time and again.

To speed up the time it takes to collect the 20% of outstanding data and documents from clients, some financial institutions are embarking on implementing web-based client portals as part of the review process, enabling their clients to securely submit required content.

Fresh compliance process required

The review or acquisition of client data and documentation may prompt the need for a full compliance refresh e.g. some materially significant changes in data may bring newer or different regulations into scope. This will be flagged by the Regulatory Rules Engine, automatically kick-starting a regulatory workflow process to complete this compliance obligation.

Change in risk classification

Based on the information submitted, the risk classification may

a) increase to a higher level (e.g. if the jurisdiction of the company changed to a FATF-defined high risk jurisdiction),

b) decrease to a lower level risk category (e.g. not trading high risk products (e.g. cash) any longer), or

c) stay the same (no new data or data that is materially changed or significant).

If there is a change in risk categorization, the solution should be capable of flagging this and kick-starting the necessary workflow processes to complete the compliance / review process.

Off-boarding clients / accounts

Throughout this process, the institution may identify some clients with which it may choose to terminate business in an effort to maintain risk-based compliance with relevant regulations and to regain balance in the bank's risk portfolio. The technology should be capable of putting in place a workflow process to off-board these clients or accounts.

Final KYC review sign-off

To ensure rigor in the compliance process, the KYC client review process should be officially signed-off by suitable experienced staff on a risk-sensitive basis (e.g. MLRO sign-off for high and medium risk clients etc.). For this, task-assignment functionality and a dashboard visibility of all required tasks to be completed, reviewed or signed-off should be made available to members of the team depending on their role in the review / approval process.

©Fenergo 2015

Reschedule next client reviews

Once the client review process has been completed and based on the client's risk score, the KYC solution should be capable of scheduling the next review process automatically either based on FATF-recommended review periods or those dictated by the financial institution.

Event-triggered lifecycle compliance

By integrating with the client onboarding and entity data management solutions, the KYC solution should also be capable of responding to event or lifecycle data that occurs during the natural lifetime of the client e.g. onboarding of new products, change of jurisdiction etc. In doing so, the solution can help the institution to maintain lifecycle compliance and not be dependent on the periodic review process to capture this information.

Auditable record of compliance ready for regulatory scrutiny

At the end of the review process, the financial institution will have a fully auditable record of compliance that is regulator-ready. This will include the recording of all compliance decisions (simplified due diligence, enhanced due diligence and ongoing due diligence), as well as the data and documentation back-up required to evidence the basis for these decisions.

Project management tracking and review

As part of the overall KYC client review project, it is important for resourcing allocation and prioritization purposes to track and measure the amount of time it has taken to complete the review process. The KYC solution should be capable of tracking and time-stamping the time it has taken to complete the process – from start to finish.

In the next section, we take a look at how two Fenergo clients overhauled their KYC client review process.

©Fenergo 2015

6 USE CASE EXAMPLES

In this section, we take a look at two Fenergo clients who have recently undergone a review of their KYC client review processes in an effort to build in greater efficiency and control into the process.

Client One: Global Wealth Management Firm

Recognized as one of the Top 10 largest wealth managers in the world, this financial institution serves high net worth and ultra-high net worth clients in Canada, the US, Latin America, Europe, the Middle East, Africa and Asia.

The Project:

Up until recently, the bank's periodic KYC client reviews and remediation processes were undertaken on a manual basis. The institution has four client risk categorizations:

- H1 – low-high risk
- H2 – medium-high risk
- H3 – high-high risk
- Restricted (where relationships are ceased).

The primary aim of the project was to review all H2s (medium-high risk clients) to ensure that they are fully compliant with AML / KYC regulations. A secondary objective was to use this remediation process as an opportunity to ensure that all clients are happy for their data to be shared across jurisdictions. Previously, data could not be shared across jurisdictions and an employee may have had to physically travel from one jurisdiction to another to access or see details of a client.

The Process:

Leaving the H3s (high-high risk clients) to be manually reviewed and remediated by an expert AML / KYC team, this financial institution took initial H2 AML assessments (which gave them their H2 classification) and brought these into the Fenergo application for assessment against a set of checklists. This process involved ensuring that all client-specific information fields contained the correct data e.g. country of residence, country of tax domicile etc. To achieve this, they need to change from a traditional product / account-focused view of the client to a legal entity view in an effort to ensure that all legal entities are correctly matched to create a more accurate and holistic record. The Fenergo Client Lifecycle Management application performed the matching and remediation process.

The Result:

The process has enabled the global wealth management firm to move from an account / product-centric view to a more client-centric view of all their clients, providing them with a more accurate view of the total number of legal entities with which they have a relationship. The automation of the client review process has helped them to make more informed and consistent compliance decisions about each client based on the final risk rating applied. The solutions has also enabled them to manage the client review workload more efficiently through the use of MI reports.

©Fenergo 2015

Client Two: Global Institutional Bank

Considered the world's largest manager of private wealth assets, this financial institution provides investment banking, asset management and wealth management services to private, corporate and institutional clients worldwide.

The Project:

The focus for this institution was to improve the efficiency of the KYC review process. The institution classifies client risk into three levels:

- 160 high risk clients – reviewed every 6 months;
- 2,500 medium risk clients – reviewed annually;
- 7,000 low risk clients – reviewed periodically ever 3 years.

The financial institution wanted to improve efficiency of the overall review process. It was estimated that the institution spent 24 hours of interactive time for every review (medium or high). If we take the example of medium high risk client category above, this translates to:

24 hours x 2,500 clients = 60,000 hours*

*This calculation does not take into account additional elapsed time for review (i.e. the time it takes for clients to respond to the financial institution's request for additional or updated data and documentation).

The Process:

The financial institution decided to maintain reviews of high risk clients as a manual process, providing the much needed expert four-eye process required. However, they wanted to automate as many of the medium and low risk clients as possible. To do this, they brought the clients initially classified as medium or low risk into the Fenergo solution. This process involved ensuring all fields were mapped to and contained the correct data. This data was fed into the Fenergo Rules Engine, which identified all of the regulations that had to be complied with, the KYC questions that needed to be asked and all the classifications that had to be performed. In addition, it determined all of the data and documents required to comply with these regulations and identified if these attributes were held by the financial institution already (collected under a previous regulation e.g. AML or KYC). The solution also tracked for expired documents.

For all outstanding pieces of data and documentation identified as necessary to comply with the stated regulations, the financial institution performed an outreach program to clients to request submission. The ability to re-use existing data and documentation streamlined and expedited the collection of the outstanding required data and documents.

The Result:

The end result of this project culminated in the creation of more comprehensive client records, speedier client review process and shaved off 12,000 hours (20%) from the medium client risk category alone.

©Fenergo 2015

7 Conclusion

In this paper, we've established that the KYC periodic client review process is extremely resource-intensive, representing up to 60,000 hours of interactive time for one financial institution to complete the client reviews for its medium-risk category alone (based on 2,500 clients).

It's quite apparent that the traditional approach of applying brute force to the problem is not the answer, resulting only in driving up the total cost of compliance. In light of continued and in some cases increased regulatory scrutiny, financial institutions need to have the utmost confidence in their KYC and AML compliance processes. A huge part of continued compliance throughout a client's lifetime revolves around the institution's ability to capture and respond to lifecycle events and data – especially those that are materially significant - and to implement a regular review process that captures data and events that may not constitute a materially significant change.

Fenergo advocates for financial institutions to review their processes and analyze the parts of the periodic review process that can be supported more by KYC, Client and Counterparty Data Management and Client Lifecycle Management technology solutions.

By applying rigorous rules logic to the client review process, financial institutions can remove a lot of the human interpretation of applicable regulations that currently takes place, helping them to identify all of the regulations, classifications and risk assessments that are in scope for the client based on the data provided.

The ability to integrate with a centralized client and counterparty data can help financial institutions to re-use data and documentation already held in client repositories within the bank that may have been collected for other regulatory purposes and speed up the time it takes to complete the client review process. Furthermore, integration with key industry data providers is absolutely essential for the creation of a more robust, accurate and comprehensive client record. Having a technology solution that seamlessly interfaces with these data providers and consumes this data helps to eliminate costly and error-prone manual data processing.

The ability to automatically calculate a risk score based on the review process (either through the addition of new data, documentation or application of new regulatory rules) is critical to eliminating the threat that human error or misjudgement may pose.

Risk scores should be automatically compared to previous risk scores to determine the delta between the two, providing a fully auditable process of any change in risk score, weighting or attributed data and documentation.

©Fenergo 2015

In this way, by automating as much of the KYC periodic client review process as possible, financial instituations can:

1. Ensure a rigorous, risk-based approach to AML / KYC compliance.
2. Maximize the opportunity to close compliance gaps in data and documentation.
3. Build an accurate client risk profile and measure the bank's overall exposure.
4. Identify relationships that need to be terminated for the overall compliance or financial health of the institution.
5. Reduce the time and number of staff it takes to conduct reviews.
6. Ensure continued compliance through event-triggered data enrichment and compliance processes.
7. Focus on newer or enhanced regulations safe in the knowledge that it complies with existing regulations.

For more information on Fenergo KYC Client Reviews, please email info@fenergo.com or visit our website at www.fenergo.com.

Kind Regards,

Joe Dunphy,

VP Product Management, Fenergo

©Fenergo 2015

8

About the Author:

Joe Dunphy, VP of Product Management.

Joe joined Fenergo in 2010 and is responsible for the overall delivery of product strategy and design across the Fenergo suite of applications. With a strong background in regulatory compliance solutions, Joe has deep banking and regulatory knowledge and maintains currency of knowledge in this ever-evolving industry by taking an active lead in Fenergo's Client Advisory Boards and industry roundtables, as well as participating in industry regulatory forums. Prior to Fenergo, Joe spent four years as Project Manager for Lloyds Banking Group and three years previous working in banking operations for Bank of Scotland (Ireland) Limited. Joe holds a Master's in Business Studies from University College Dublin, Smurfit School of Business, a postgraduate Diploma in Business Systems Analysis and Bachelor of Commerce Degree from National University of Ireland.

More Fenergo Publications:

Check out the Industry Knowledge section of www.fenergo.com for more industry publications such as:

- Managing the Delta of Regulatory Data
- Research – Total Economic Impact of Client Lifecycle Management Solutions
- Regulatory Landscape for Capital Markets in 2015 (see also special APAC edition)
- Surviving the Perfect Storm: Making the Case for Client Lifecycle Management
- Riding the Wave of Utilities in a Tsunami of Regulation
- Implementing Rules-Driven, Risk-Based Regulatory Onboarding and KYC Processes
- Managing Client & Counterparty Documentation in a Regulatory World
- Regulatory Onboarding – The Fenergo Way
- AITE Research - Keeping Calm and Under Control: Legal Entity Data Support in a Regulatory Age
- Getting to Grips with Client & Counterparty Data Management
- Client Onboarding: Solving the Challenges, Maximizing the Opportunities

For more information on Fenergo, visit www.fenergo.com.
Check out our latest whitepapers and client case studies.

Alternatively, please email us at **info@fenergo.com.**

Follow us on @Fenergo or join the discussion Fenergo

©Fenergo 2015

9 About Fenergo (www.fenergo.com):

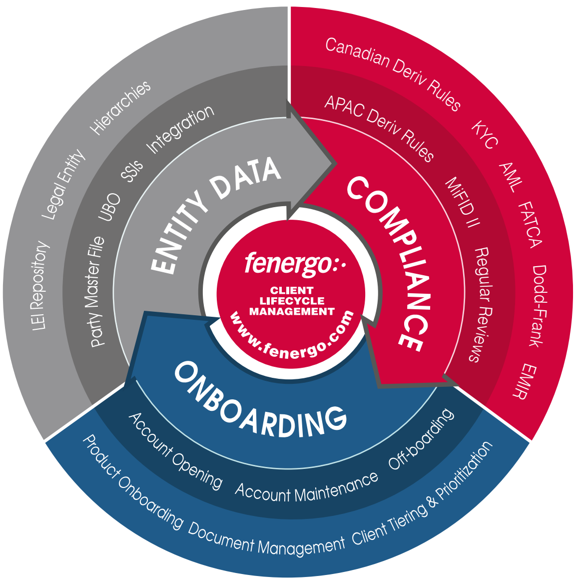
Fenergo is a global leader in Client Lifecycle Management software solutions for capital market firms and investment banks. Its world-class client onboarding workflow technology streamlines onboarding, account opening and client maintenance processes, while delivering regulatory onboarding processes that ensure compliance with global and local regulations based on clean, golden source entity data. These regulations span Anti-Money Laundering (AML), Know Your Customer (KYC), FATCA and OTC Derivative Reform regulations such as Dodd-Frank, EMIR, MiFID, Canadian and APAC derivative rules).

Fenergo takes a unique approach to regulatory onboarding and entity data management. Built upon three core product pillars (Client & Counterparty Data Management, Regulatory Compliance Management and Client Onboarding Lifecycle Management), Fenergo's enterprise-wide Client Lifecycle Management platform is designed to help financial institutions manage client and counterparty data, comply with new and emerging regulations and onboard clients and products quickly and efficiently – all on a single platform solution.

Comprised of three core software solutions, Fenergo's Client Lifecycle Management platform includes:

Client & Counterparty Data Management

Fenergo's Client & Counterparty Data Management solution is a centralized master data system designed to help financial institutions to acquire, validate, store and distribute legal entity data across product lines, business lines and jurisdictions. It allows tracking, merging and grouping legal entity identifiers to create a holistic single view of the client and all its associations.



Regulatory Compliance Platform

Fenergo's Regulatory Compliance Management solution ensures compliance for the financial institution throughout the entire lifecycle of the customer and across global compliance and regulatory directives, such as: Jurisdictional KYC (Know Your Customer), Client Due Diligence Checks, Anti-Money Laundering Checks, Ultimate Beneficial Ownership Checks, FATCA, MiFID, Dodd-Frank and EMIR Classifications, as well as compliance with the Patriot Act and the 3rd and 4th EU Money Laundering Directives.

Client Onboarding Lifecycle Management

Fenergo's Client Onboarding Lifecycle Tool enables financial institutions to improve time to revenue and provide a quick and efficient onboarding process for new and existing clients, whilst ensuring the highest level of compliance with ever-evolving regulations all the way through the client lifecycle (at client take-on and ongoing due diligence stages).

©Fenergo 2015

Global Headquarters: Ormond House, Ormond Quay, Dublin 7, Ireland.

T: +353 1 901 3600   E: info@fenergo.com   W: www.fenergo.com

About Fenergo

Fenergo is a global leader in Client Lifecycle Management software solutions for capital market firms and investment banks. Its world-class client onboarding workflow technology streamlines onboarding, account opening and client maintenance processes, while delivering regulatory onboarding processes that ensure compliance with global and local regulations based on clean, golden source entity data. These award-winning solutions enable financial institutions to significantly improve time-to-revenue, regulatory compliance, client experience, and reduce overall operational costs.

©Fenergo 2015