



Is your KYC implementation effective?

By Milind Khade
GRC AML Solutions Lead for
Banking & Capital Markets

Abstract

Federal banking supervisory authorities in the US have identified the deficiencies in the implementation of BSA/AML compliance program in large global banks. For a financial institution, customer risk assessment is pivotal in managing risks related to money laundering and financing of terrorism which means an effective KYC (Know Your Customer) implementation is the key. AML product makers recognize the need of a central KYC/CDD hub for effective customer risk assessment. However, in most banks, there are gaps in the KYC implementation within the legacy and siloed KYC/AML systems.

This document provides a brief note on the gaps in current implementations, challenges in efficient implementation and a strategic approach for effective KYC implementation.

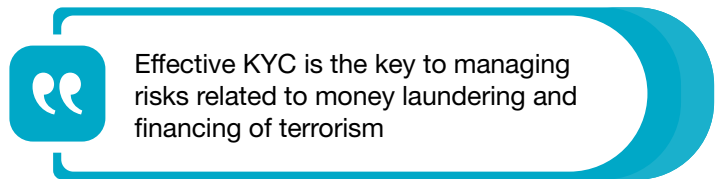
Introduction

Bank Secrecy Act (BSA) is the primary US Anti-money laundering (AML) law which had been amended to include certain provisions of the USA Patriot Act to detect, deter and disrupt terrorist financing networks. As a part of this law, financial institutes need to establish and monitor BSA compliance program. Other than the reporting requirements, it requires them to follow specific customer identification and verification procedures, guidelines while opening an account, record keeping and comparison with government lists. It also requires them to establish a due diligence program which includes policies, procedures and controls, that enable in detection and reporting of any known or suspected money laundering activity on an ongoing basis.

Similarly, Financial Conduct Authority (FCA) also emphasizes on the customer's identification, verification of the identity, understanding the purpose and intended nature of relationship, and collection of information of beneficial owner towards having a clear understanding of risks associated with the business relationship and provide a meaningful basis for subsequent monitoring.

Although most banks have established AML governance in terms of policies and processes, they have siloed KYC and AML systems. As a part of Customer Due Diligence (CDD), customer's profile and risk score gets created. During ongoing CDD, other than the time which gets consumed in the manual interactions for revisiting the customer profile, the gaps in typical KYC systems are as follows:

- Customer information gets screened against latest watchlists on a daily basis. However, if there is a suspicious or high risk customer, the information being transferred to CDD system is not automatic and may not necessarily reach the KYC analyst towards revisiting the customer's profile.
- Customer's behavior gets monitored against its profile and if there is no mechanism of feeding the latest profile details to the behavior monitoring system, the purpose of monitoring the deviation in behavior does not get served.
- Customer's behavior gets monitored against its profile and if there is any deviation, the updated information gets transferred to CDD system manually and may not necessarily reach the KYC analyst towards revisiting the customer's profile.



Challenges

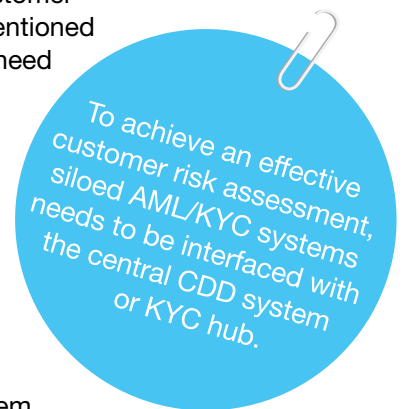
There are some challenges in integrating the KYC/AML systems with the central KYC hub. The challenges can be:

- Banks may have different vendor products for customer onboarding, CDD, watchlist screening and transactions monitoring. This may result in issues while mapping customer profile data elements coming out of the third party products used in AML systems and the central KYC hub.
- Establishing the interfaces and schedules to refer and update the profile data elements and customer risk score to and from the central KYC hub.

Point of view on the approach

To achieve an effective customer risk assessment, below mentioned siloed AML/KYC systems need to be interfaced with the central CDD system or a KYC hub.

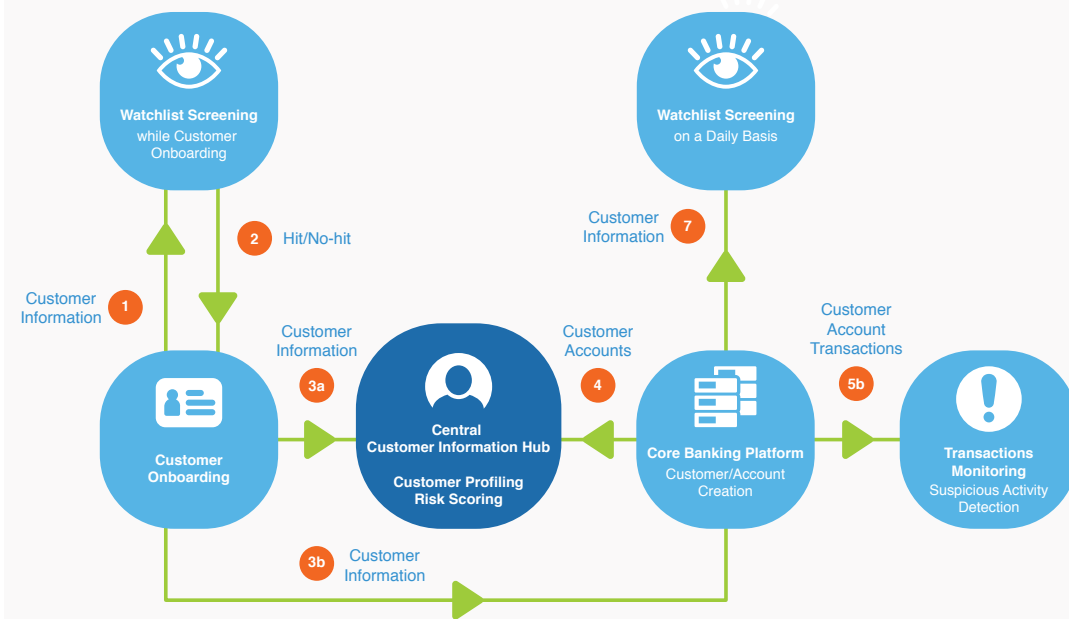
- Customer onboarding system
- Transactions monitoring system
- Customers/Transactions watchlist screening system



The central system takes care of customer due diligence, enhanced/special due diligence for PEP (Politically Exposed Person) or high risk customers.

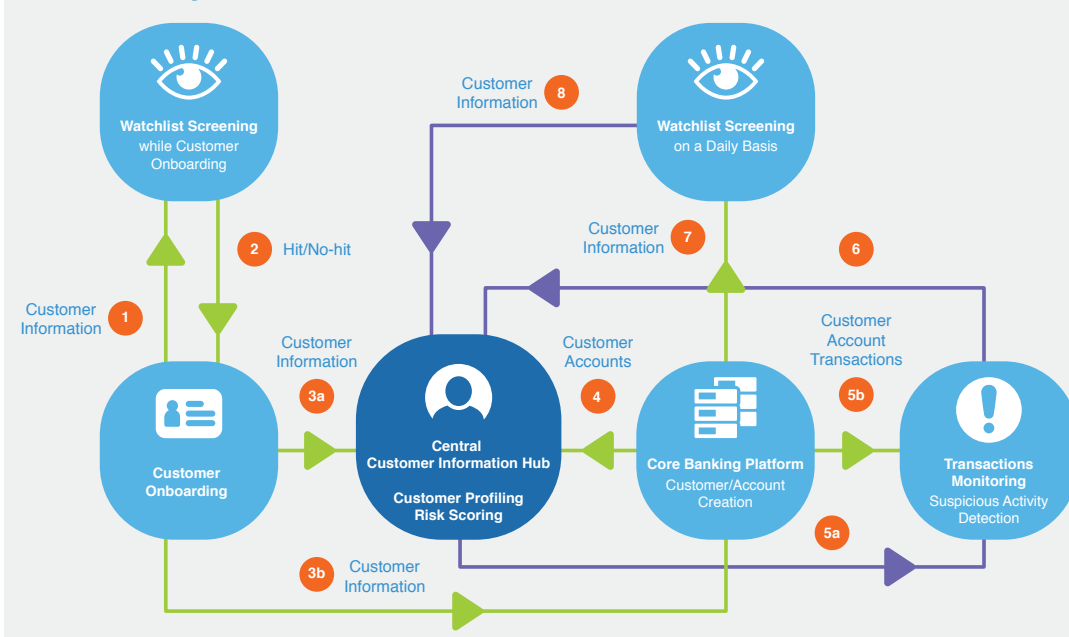
Here is a representation of a typical KYC implementation and an effective KYC implementation with data flow.

Typical Implementation



- 1 Request for watchlist screening
- 2 Response from watchlist screening system
- 3a Send the verified customer information to KYC hub
- 3b Send the verified customer information to the core banking platform
- 4 Send the customer and account information for CDD to generate the customer profile and risk score
- 5a Send the latest customer profile/risk details for suspicious activity monitoring
- 5b Send the customer, account, transactions details for suspicious activity monitoring
- 6 Send the changes in customer behavior towards updating the profile and risk score
- 7 Send the customer details for watchlist screening
- 8 Send the customer details if there is a hit resulted in watchlist screening towards updating the profile and risk score

Effective Implementation



The highlighted additional interfaces/flows in the new approach fills the gaps mentioned earlier. The additional flow (5a) makes sure that the suspicious activity or behavior deviation detection uses the latest customer profile information. The additional flows (6 and 8) are the auto triggers for a manual action (by KYC analyst) of revisiting the customer profile with the latest changes identified during ongoing customer due diligence.

Conclusion

For better management of money laundering risks, organizations need an effective KYC implementation. Efficient flow of information within the integrated KYC/AML systems fills the gaps in current KYC systems. The discussed approach will help banks with a better understanding of customer relationships resulting in better AML compliance.

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3. Office of the Comptroller of the Currency: <http://www.occ.gov/topics/compliance-bsa/bsa/bsa-regulations/index-bsa-regulations.html>
4. Federal Financial Institution Examination Council (FFIEC): https://www.ffiec.gov/bsa_aml_infobase/pages_manual/manual_online.htm

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Evaluarc is a framework for evaluating an organization's AML Risk and Compliance. There are several modules, assessment kit helps to bench mark the current compliance levels, regulatory guidance kit for implementation. There are solution accelerators like an automated test suite, suspicious patterns detection suite that help in reducing false positives thus reducing operations costs. Evaluarc can be deployed to help improve AML compliance program effectiveness and prepare the organization for future regulatory mandates.



Milind Khade

GRC AML Solutions Lead for Banking & Capital Markets

Milind is a senior IT professional with over 16 years of experience. He has led multiple projects for large global banks in payments, billing and regulatory compliance domain.

As a part of GRC Competency Group, he gets involved in building accelerators, leading/designing AML solutions and working on proposals.

Milind Khade can be reached at Milind.Khade@mphasis.com

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For more information, contact: marketinginfo@mphasis.com

USA

460 Park Avenue South
Suite #1101
New York, NY 10016, USA
Tel.: +1 212 686 6655
Fax: +1 212 683 1690

UK

88 Wood Street
London EC2V 7RS, UK
Tel.: +44 20 8528 1000
Fax: +44 20 8528 1001

INDIA

Bagmane World Technology Center
Marathahalli Ring Road
Doddanakundhi Village
Mahadevapura
Bangalore 560 048, India
Tel.: +91 80 3352 5000
Fax: +91 80 6695 9942



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