WHITE PAPER

PERPETUAL KYC:

The future of due diligence?

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PERPETUAL KYC

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INTRODUCTION



Digital transformation is changing due diligence processes and periodic risk assessments. The law requires financial institutions (FIs) and other regulated entities to conduct ongoing due diligence to gather comprehensive and up to date information about the nature and purpose of customer relationships. However, existing know your customer (KYC) systems often hinder the efforts of FIs: average customer onboarding time has become longer, KYC processes are often laborious, repetitive, and highly manual, and information updates are typically based solely on review and refresh processes. [1]

Additionally, the cost of anti-money laundering (AML) compliance is rocketing. In April 2020, the Europe, Middle East and Africa (EMEA) region was reported to be spending USD 137 billion on financial crime compliance annually.[2] These figures are only expected to rise, as regulators increase their pressure on financial institutions to enhance their KYC efforts. Rightly so: a strong KYC regime is the foundation of effective financial crime compliance programmes. Consequently, FIs and regulators are increasingly looking towards digital solutions as an opportunity to transform their operations and surmount the problems associated with periodic KYC assessments.

“Perpetual KYC”, also known as “continuous KYC”, event-driven KYC”, or “dynamic KYC”, is based on the dynamic refresh of customer data in response to key triggering events. It represents an adaptive approach to KYC processes in comparison to the more traditional, reactive ways of updating KYC information. However, a successful transition towards this dynamic approach depends on a few pre-conditions being met. Firstly, the organisation in question must have reached an advanced level of data maturity and system integration. Secondly, its compliance team must have a good understanding of what constitutes a meaningful change that would represent a trigger for KYC processes. Finally, the importance of cultural buy-in on behalf of senior management cannot be underestimated, although this is not something that is always easy to achieve.

This white paper seeks to examine the concept of Perpetual KYC, evaluating its benefits, challenges and feasibility as a solution, and assessing current regulatory approaches towards innovation in KYC processes. The analysis draws upon desktop research and relevant findings from a survey on “Innovative approaches to KYC” that was circulated by Themis among KYC practitioners and heads of compliance departments. It focuses on the opportunities associated with implementing more dynamic KYC processes, the consequences for FIs and data providers, and the aspects that need to be kept in mind by organisations before embarking on a Perpetual KYC journey.

The paper concludes that Perpetual KYC is an interesting approach to work towards that can offer improvements on current solutions in terms of efficiency and effectiveness. However, before deciding to implement it, an organisation must ensure it has reached high levels of data quality, consistent and mature KYC standards, and cultural buy-in from senior management, if it wants to see the desired gains.

WHAT IS PERPETUAL KYC?



Perpetual or dynamic KYC refers to continuous monitoring for events that would alert an institution about the need to review and update its customer information. It consists of due diligence based on the discovery of data triggered by:

- A new event in the external information universe, such as a change in facts relevant to a risk assessment or the emergence of new information e.g. a new customer relationship with a Politically Exposed Person (PEP), the implementation of new sanctions, new pieces of adverse media, or fresh law enforcement investigations or operations regarding an individual or a company;
- A notification from an existing customer that the data they previously provided about themselves has changed;
- An event in an internal system such as an internal monitoring update;
- The recording of something suspicious during the monitoring of transactions, payment screening, or credit risk analysis, that is of significance to a current risk assessment.

BENEFITS ASSOCIATED WITH PERPETUAL KYC

As compliance requirements continue to increase, AML compliance departments need to find ways to improve efficiency and effectiveness, ensuring more work is completed to a greater level of accuracy, yet ideally using similar resources. However, current solutions often do not allow financial institutions to keep up with the more stringent requirements and clients' requests.

According to a Themis survey on innovative approaches to KYC that was circulated among KYC practitioners and head of compliance departments, the main challenge (66.7%) in current Know Your Customer models related to the difficulty of accessing up to date data and achieving a single customer view, followed by a lack of trained personnel (45.2%) and the difficulty of analysing the large number of alerts that platforms receive on a daily basis (42.9%), as shown in Figure 1. The survey also found that, when choosing a new solution, KYC practitioners and heads of compliance departments mainly prioritise ways to reduce manual input (73.6%) and platforms that are in line with regulatory requirements (71%).



Figure 1: What do you think are the main challenges presented by current KYC methods? Choose the top three.

Customer reviews have traditionally been conducted by FIs on a periodic basis, following a risk-based approach (RBA), according to which review frequency depends on customers' classification by the FI as high, medium or low risk. On average, it can reportedly take up to 20 days per file to refresh a client's details - an approach that the industry now increasingly recognises as one that exposes financial institutions to risk of outdated or inaccurate information. This is due to the fact that, during the time between one review and the next, customer information can alter significantly, including due to changes in income levels, country of operation, or new, higher risk linkages with sanctioned individuals or PEPs.

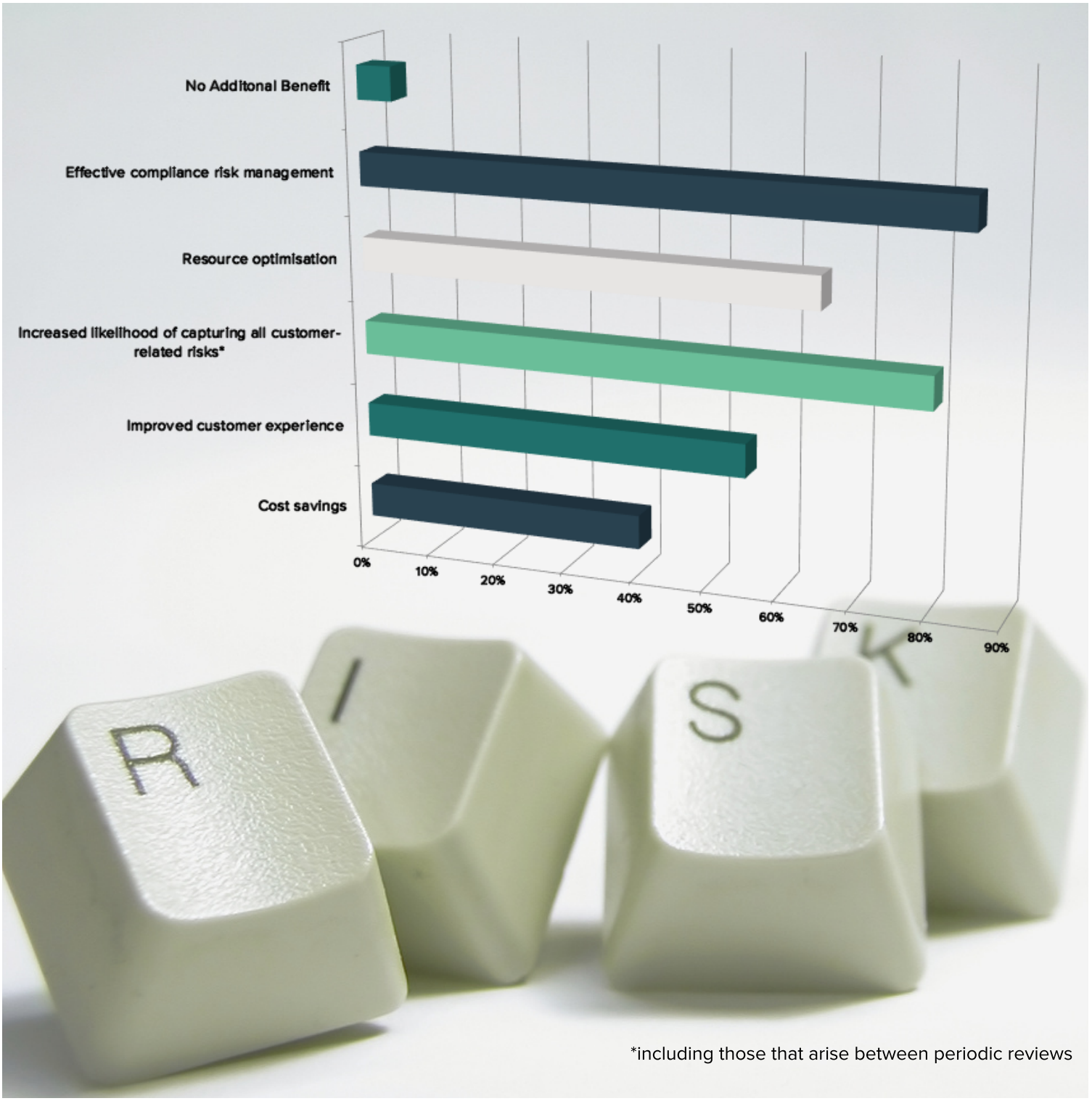
Perpetual KYC could represent an innovative solution that would enable the eradication of unnecessary KYC reviews while ensuring that data and risks related to all parties are continuously updated. Figure 2 shows that a large majority (80.0%) of KYC practitioners and heads of compliance who participated in the Themis survey agreed that, by relying on this dynamic approach, financial institutions would be more likely to spot the risks that may arise under their watch between periodic reviews.

Respondents also deemed effective compliance risk management to be the greatest benefit (85.0%) associated with Perpetual KYC. This could be because, rather than rely solely on periodic refreshes of due diligence and risk decisioning, Perpetual KYC operations can opt to listen for signals generated in their internal systems and in external data sources in 'real-time'.

Aside from enabling more effective compliance risk management, an operating model that enables Perpetual KYC could reduce compliance costs by increasing straight-through processing (STP), enabling more management by exception, and minimising the build up of out-of-date records which need to be urgently addressed at a premium cost via outsourcing or recourse to additional resources. Perpetual KYC also helps to avoid the accumulation of 'back-books', which are large sets of records that need to be refreshed or remediated all at once - a process that can be extremely costly and difficult to resource in line with regulatory deadlines. [3]

Customer experience could also benefit from aspects of a Perpetual approach, if they can leverage data in a digital format for real time benefits downstream. 55.0% of respondents to the Themis survey on innovative KYC solutions thought their customer experience could be improved through dynamic KYC. This is mainly because this form of KYC could reduce compliance touch-points with the customer during and after onboarding processes. With Perpetual KYC, the ideal is for FIs to only reach out to customers following a meaningful concrete change in data, thus scaling back the need for customer box-ticking in a regular review cycle or in response to a false positive.

Figure 2: What are the benefits you believe could be achieved through Perpetual KYC, if any?



*including those that arise between periodic reviews

CHALLENGES ASSOCIATED WITH PERPETUAL KYC



Although Perpetual KYC offers several potential improvements on current KYC methods, it remains a rather-unexplored process in the compliance sphere.

Over half of respondents to the Themis survey (51.3%) replied that they were not familiar with the concept of Perpetual or dynamic KYC.

This is mainly due to the relative novelty of the concept, which has not yet been fully explored by regulators and practitioners, but also due to a series of challenges that have already been associated with its implementation, and to an attachment to current KYC processes which prevents FIs from adopting new approaches.

The potential increase in costs associated with Perpetual KYC could represent a challenge that outweighs the initial benefits of having a dynamic KYC approach in place. This could be related to the implementation of new measures, technologies and personnel training to accompany the development of Perpetual KYC operating models, but also to the type of commercial agreements in place which enable regulated entities to gain access to information stored by commercial data suppliers. These challenges were recognised by KYC practitioners and heads of compliance: as part of the Themis survey, 75% of respondents indicated necessary upgrades to IT infrastructure as the main challenge posed by Perpetual KYC rollout.

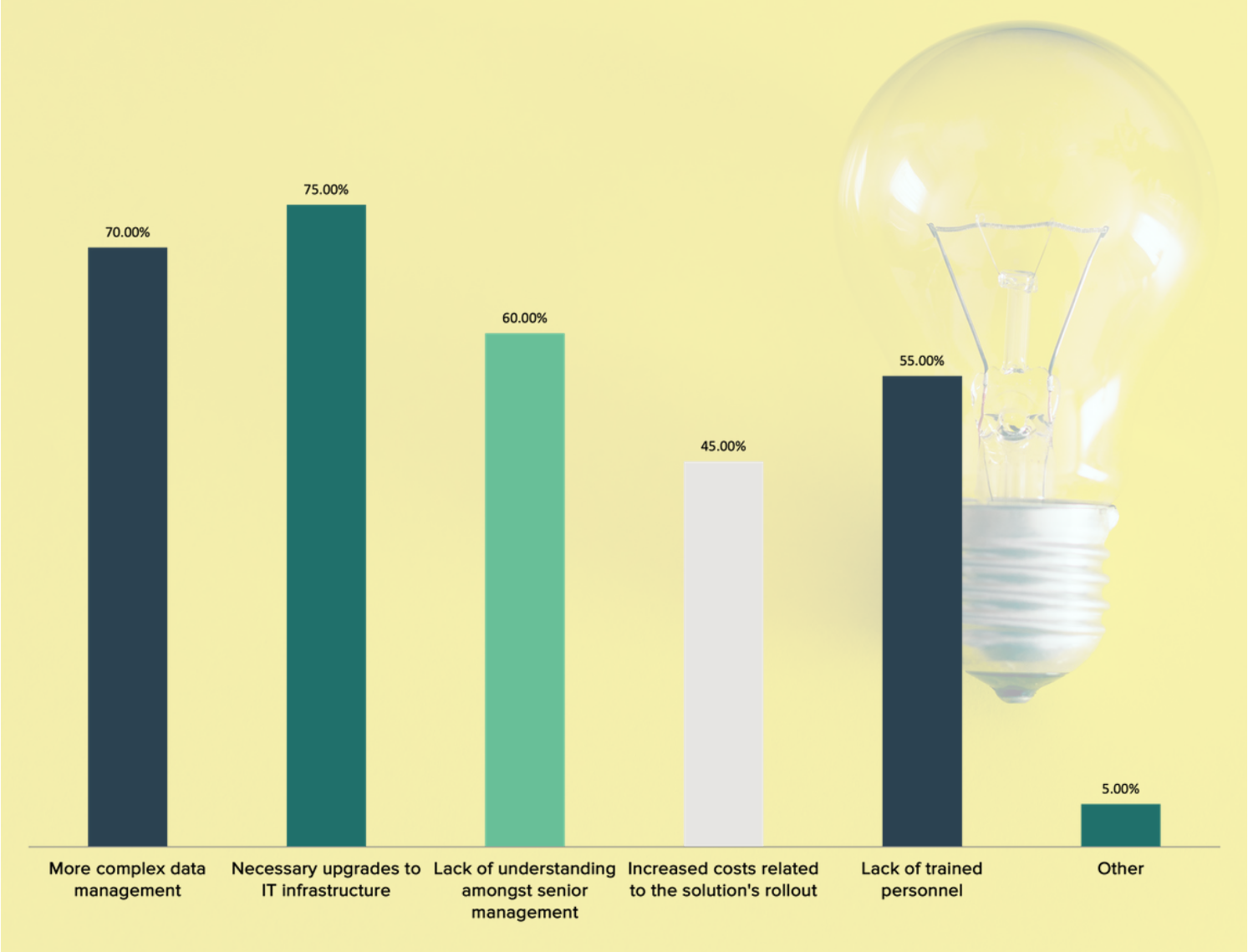
The increase in data management complexity associated with dynamic KYC solutions also appears to be a cause of concern for a majority of survey respondents (70.0%), as demonstrated in Figure 3 below. Large financial institutions usually house customer data across multiple systems and often struggle to leverage customer data collected outside typical KYC operations. As shown in Figure 3, practitioners also believe that, to undertake Perpetual KYC, they would need to develop digital capabilities that enable a single customer view across KYC and other operations, such as sanctions or tax compliance. However, only 23.5% of Themis survey respondents believed their organisation had reached a point of data maturity and systems integration that made it ready to adopt the practices commonly associated with Perpetual KYC. An additional 47.0% of practitioners were aware their systems were still far from reaching an appropriate level of data maturity, even though they claimed to be working towards this.

As part of their quest to achieve digital maturity, organisations also have to let go of legacy standards such as paper-based processes for document and data gathering. Not only is this a costly endeavour, but it also requires firms to think about KYC differently - a change in culture that not everyone is ready to welcome.

While increases in costs and data management requirements represent key challenges for some institutions with a potential interest in Perpetual KYC approaches, the biggest obstacle is often poor understanding of KYC processes by corporate decision-makers. If it is to be rolled out seamlessly and comprehensively, Perpetual KYC requires appropriate cultural buy-in on the part of a company's management, who need to feel confident enough in the value of any new solution to move away from trusted manual processes. This confidence stems largely from a belief in efficiency and productivity gains, as outlined in the next section.

This comprehensive change in attitude does not appear to have taken place yet. 60.0% of respondents to the Themis survey saw lack of understanding amongst senior management and lack of proper personnel training as two of the greatest challenges facing financial institutions considering a rollout of more dynamic KYC solutions. A vast majority (89.2%), however, believed that their organisation had a good understanding of what constitutes a meaningful change that would represent a trigger for KYC processes. This is a good starting point for any organisation seeking to embark a journey towards more dynamic KYC solutions.

Figure 3. What are the challenges you believe are presented by Perpetual KYC implementation?



MOVING TOWARDS PERPETUAL KYC: FACTORS TO CONSIDER

Given the challenges that adopting Perpetual KYC processes can pose, caution is required. The transition to a dynamic, risk-driven approach of ongoing KYC requires financial institutions to deploy information already held within their organisation and then integrate it with external data sources. Automation is obviously critical to this, and there are already a number of RegTech platforms that facilitate the move towards dynamic KYC and could be particularly helpful for organisations that feel overwhelmed at the prospect of a radical change in their KYC processes.

The Themis survey found that, while 17% of respondents had started rolling out Perpetual KYC solutions, 47.1% were currently exploring alternative solutions to their KYC platforms.

Respondents indicated automation and machine learning as potential enhancements which could reduce manual and repetitive tasks. For instance, some solutions collect data from multiple sources that go beyond basic KYC information, while others use Robotic Process Automation (RPA) and other Intelligent Automation (IA) [4] tools to update customer data with minimal human intervention when a material or high-risk change is flagged during the review. Other practitioners indicated they were exploring electronic identification (e-ID) and verification services, or indeed any other solutions that would streamline digital KYC processes, reduce the need to upload irrelevant documents into source systems, improve data administration, and reduce the need for data replication across different systems.

Even when an organisation is not currently interested in or does not feel ready to implement a full-scale Perpetual KYC operating model combining multiple integrated technologies, the modernisation of KYC platforms, driven by data and powered by intelligent automation, can still bring huge benefits. Any such modernisation is, to a lesser or greater extent, dependent on a shift in organisational culture and the mindset of senior management, as outlined above.

This shift in managerial outlook is likely to be fostered by concrete, data-backed evidence about the productivity, accuracy and operational efficiency gains associated with a transition to continuous approaches to KYC. Managers need to be convinced that Perpetual KYC will tangibly improve risk assessments and enable them to do more with fewer resources, including less reliance on third parties.

Managers and compliance teams need to be fully aware of what triggers a meaningful change in customer data. They must also understand that KYC is not a siloed activity, but rather one that has to be integrated within the entire customer life cycle. At the same time, an organisation needs to be confident enough in its ability to undertake a transition towards automation.

These changes in mindset do not happen overnight. However, modernisation of KYC platforms to ensure more effective and efficient data input could represent a tangible first step in any potential foundational move towards a more dynamic or perpetual form of KYC.

WHAT IS THE POSITION OF REGULATORS?



Although they have been pushing for greater innovation in compliance, the vast majority of regulators have been quiet about dynamic KYC processes thus far. 47.6% respondents to the Themis survey deemed unclear regulatory expectations and guidelines to be amongst the biggest challenges associated with current KYC processes - whilst also expressing the need to implement solutions that meet regulators' recommendations.

Clarity may sometimes be lacking, but there are interesting examples of regulators taking encouraging steps to explore innovative KYC solutions. This is particularly the case in the Asia-Pacific (APAC) region, where there are over 40 different regulators with varying anti-money laundering (AML) approaches and differing, non-standardised practices.[5] To tackle this issue, they have raised their expectations so as to align with global practices as much as possible.

For instance, in Australia, knowing whether customer data has changed is a regulatory requirement. The country's regulatory body, AUSTRAC,[6] has in fact imposed regulatory requirements regarding financial institutions' ongoing customer due diligence, which include ensuring customer information is up to date. In 2019, the Monetary Authority of Singapore (MAS) and the Institute of Banking and Finance (IBF) also commissioned a detailed study on the impact of automation and data analytics on job tasks and skills needs in the financial sector over the next 3-5 years. The study [7] estimated that half of the jobs in the country's financial sector would be improved as individuals leverage data analytics and automation to amplify their performance.

The MAS[8] and the Hong Kong Monetary Authority (HKMA)[9] have also each released principles for the use of automated solutions in the financial sector. The HKMA's principles[10] focus on better practices that include the introduction of proper governance frameworks, the need for appropriate levels of explainability of AI applications, the use of good quality data and board and senior management accountability for their institutions' implementation of AI applications. This is very much akin to the steps required for the introduction of Perpetual KYC approaches.

Finally, in the European Union (EU), even though the bloc's 6th Anti-Money Laundering Directive (6AMLD) does not specifically call for the adoption of Perpetual KYC, it does highlight the need for up-to-date technology to manage lower-risk KYC by exception.[11]

Looking at practices in EU member states, there was a notable recent case in the Netherlands in which the Netherlands Public Prosecution Service (NPPS) endorsed the principles behind Perpetual KYC. ABN AMRO, a Dutch bank, was found to have fallen seriously short of compliance with AML regulations over a number of years, including because it assigned risk classifications to a number of its clients in incorrect fashion. In its investigation of the bank, the NPPS stated that: "It is important that a bank periodically reassesses or reviews whether the client still meets its risk profile and risk classification. In addition, a reassessment must also be carried out in response to certain developments or events (event-driven reviews)." [12] It remains to be seen whether other authorities will follow suit and indicate the need for both periodic and event-based refreshing of client profiles.



CONCLUSION

Driven by the need to enhance KYC standards across the industry and reduce exposure to risk, while also managing the financial burden associated with AML compliance, regulators and financial institutions are increasingly looking to modernise their KYC platforms.

While Perpetual KYC represents an interesting approach, it is not an easy win, and caution is required in any attempted implementation. A Perpetual KYC operating model could offer improvements in terms of both efficiency and effectiveness as compared to stand alone, unintegrated existing KYC solutions. However, it can only bring the desired gains when an organisation reaches high levels of data quality, consistent and mature KYC standards, and cultural buy-in from senior management. The latter is typically driven by a belief that innovation in KYC processes will bring operational efficiency benefits and will improve the quality of risk assessments.

For those overwhelmed at the prospect of a full-blown embrace of Perpetual KYC, other solutions are emerging as a bridge between current KYC approaches and dynamic processes, especially as regulators place an increased focus on intelligent automation and voice scepticism about outsourced or managed services models.

Transitioning to continuous KYC does not only mean adopting new technology, but also cutting back on paper-based processes, taking steps to improve the quality of data and building trustworthy data trigger mechanisms. Once financial institutions have these foundations in place, they need to demonstrate the potential efficiency and productivity gains associated with Perpetual KYC, in order to engender a cultural mindset shift amongst management. Only then will Perpetual KYC be a viable operating model.



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