The Next Frontier in KYC and AML: Intelligent Automation-led Transformation

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Executive summary

With regulators increasing stringency and working to safeguard the rights of consumers globally, the burden of daily regulatory updates for major banks has risen to more than 200 a day at present from merely 10 a day in 2004.

Several banks that invested heavily in expanding their compliance teams over the last 10 years are now struggling to meet the ever-increasing compliance needs while ensuring minimal costs. Additionally, with increasing sophistication of financial crime, as the number of false positives grows, agent productivity has started getting impacted. A manual approach also faces challenges such as continuously evolving regulations, changes to existing processes, siloed nature of operations, high cost of ownership, and multiple redundant processes that are handled by different teams.

Automation is the one-stop solution for most challenges faced by banks in their compliance programs. Institutions that are hesitant to completely overhaul their processes can begin with automating transactional tasks. Further along the journey, banks can implement intelligent automation in their programs, with bots performing level 1 checks and examining false positives, to free up agent bandwidth. Agents can step in when an exception arises, further investigation is required, and to make the final call on insights generated.

Now is the right time for banks to start their automation journeys – if they have not already – and transform their compliance programs. Market factors, such as the evolving regulatory landscape, changing buyer expectations, and intensifying competition, are driving automation adoption. Unforeseen events, such as a pandemic or a natural disaster, can also severely dent banks' manually run compliance programs and expose them to regulatory threats and financial crime. At such a time, intelligent automation-enabled tools offer banks the safety net that safeguards their institutions from such risks and assists their workforce.

The pressures to improve Know Your Customer (KYC) and Anti Money Laundering (AML) processes

Banks handle several processes and checks for Know Your Customer (KYC) and Anti Money Laundering (AML), and these have been increasing and getting increasingly complex over the years. What used to be address and identity checks earlier have now evolved into complex screening- and monitoring-based periodic checks and risk assessments. Exhibit 1 depicts the complex processes and checks involved in KYC and AML.

EXHIBIT 1

Processes and checks involved in KYC and AML

Source: Everest Group (2020)

Data sources

Know Your Customer (KYC)		Anti Money Laundering (AML)	
Onboarding	**Enhanced Due Diligence (EDD)**	**Monitoring**	**Reporting**
Document management	Customer screening – Politically Exposed Persons (PEP), negative news, lists, etc.	Suspicious Activity Monitoring (SAM)/SEM	Alert management
Customer profiling and risk assessment	Data stream validation/notification	AML monitoring for Money Service Businesses (MSB)	Compliance reporting
Quality assessment		Trade surveillance	314b data requests/sharing
FATCA compliance			Legal support services

Platforms

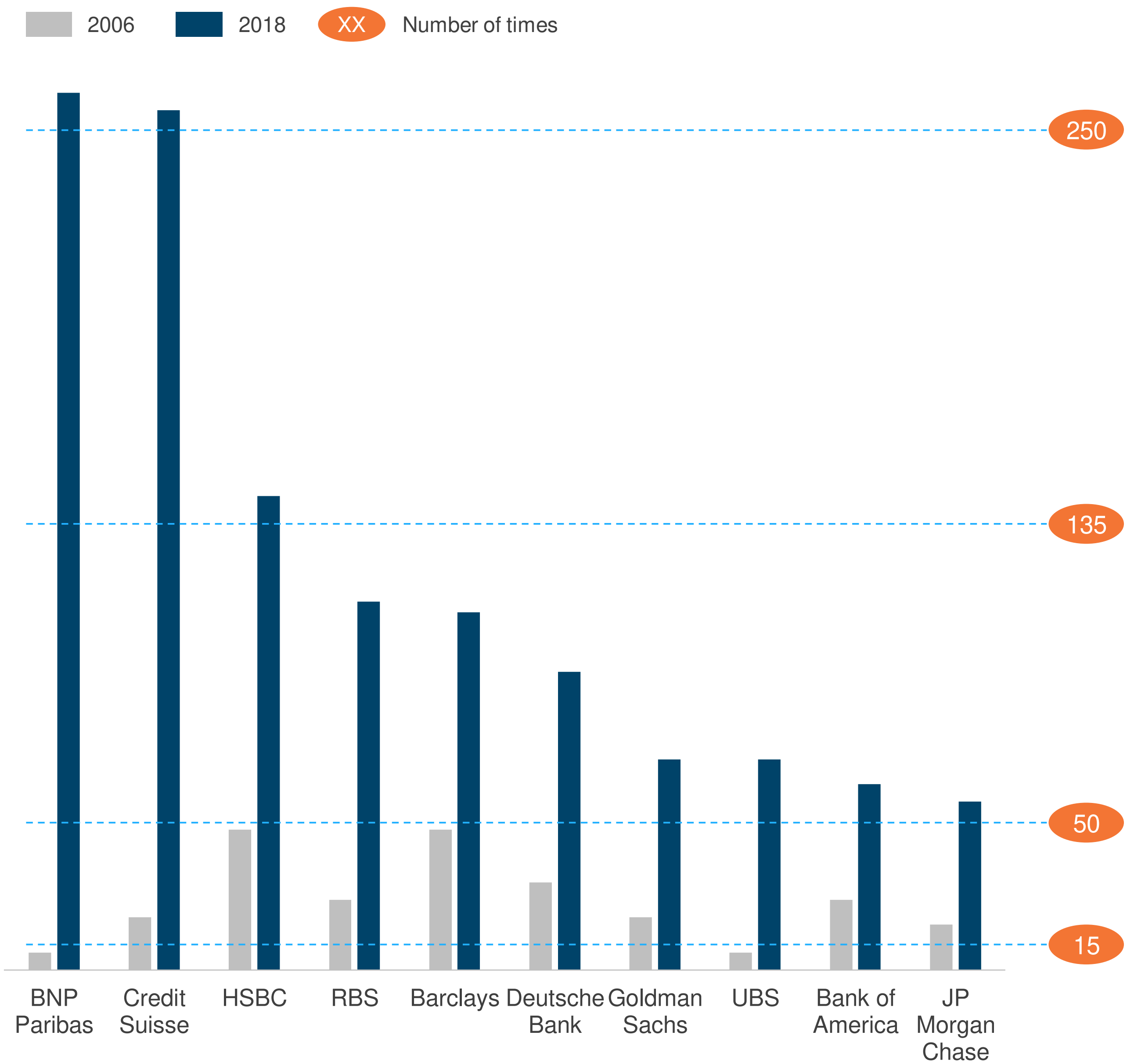
Analytics

Being noncompliant with any KYC or AML process can have severe repercussions in the form of revenue loss, reputational damage, and lawsuits. Subsequently, banks' focus on compliance has increased substantially over the last decade. Exhibit 2 showcases the number of times the word "compliance" appeared in companies' annual reports between 2006 and 2018.

EXHIBIT 2

Number of times "compliance" was mentioned in companies' annual reports over 2006-2018

Source: Everest Group (2020); the Economist



In the past, banks have paid hefty fines and penalties for noncompliance and incurred significant costs to become compliant. Here are a few notable instances:

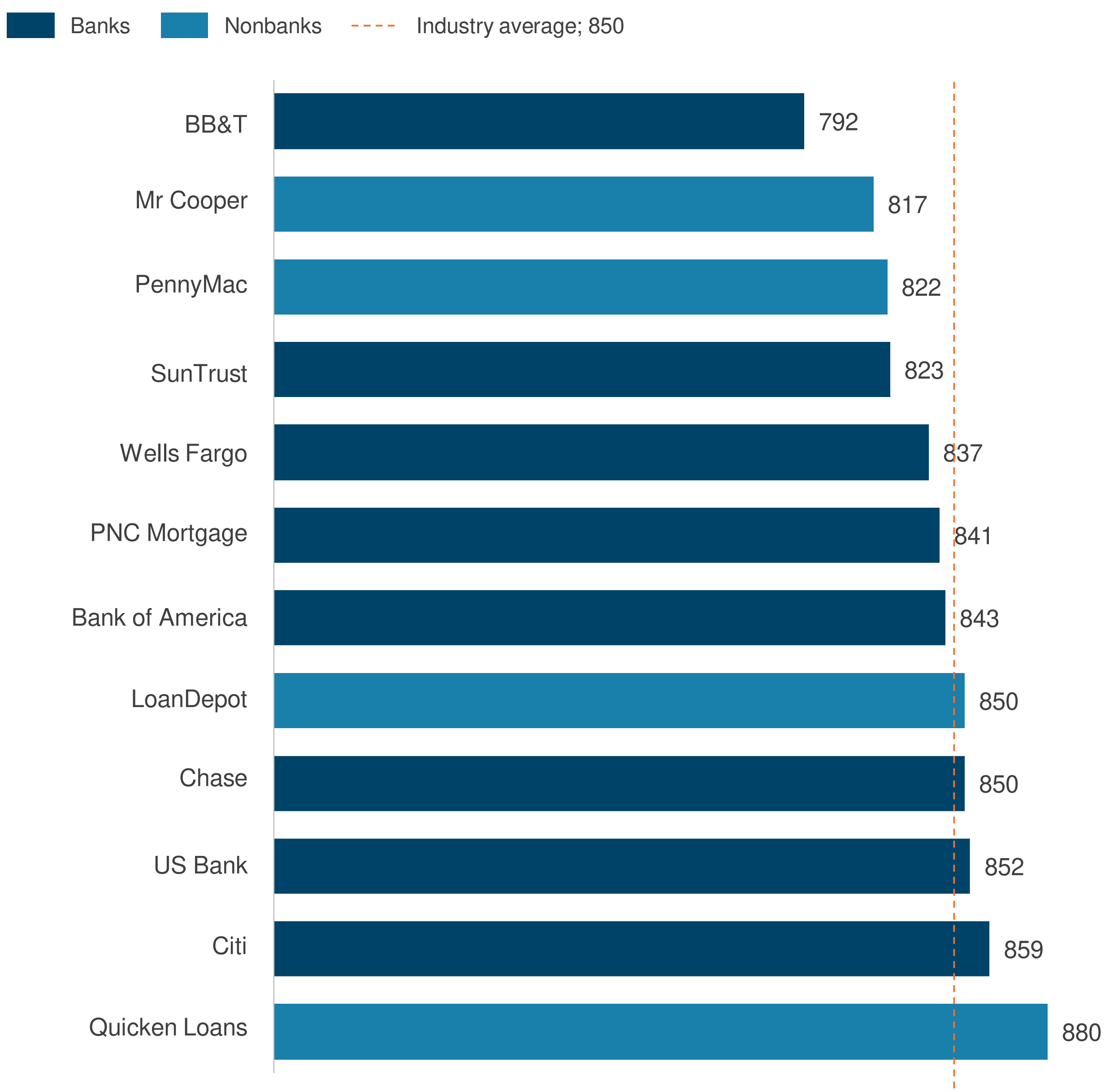
- The estimated cost for banks to implement changes/checks for MiFID II compliance launched in January 2018 was US$800 billion globally
- Since the financial crisis of 2008, banks have paid over US$204 billion in compliance-related fines and infractions
- In 2019, Citigroup Inc., Royal Bank of Scotland Group Plc, and JPMorgan Chase & Co. were among the five banks that agreed to pay the European Union fines totaling US$1.2 billion for colluding on foreign-exchange trading strategies

Having said that, regulatory pressure to improve KYC and AML processes is only one side of the story. Banks are primarily led by improving the customer onboarding experience, which has now become a key differentiator in the banking industry. Digital-first and non-banks are raising the bar in enhancing the customer onboarding experience while being compliant. Banks that still rely on age-old methods of manual data collection and processing usually have longer turnaround times for decision-making, compared to non-banks, impacting customer experience.

EXHIBIT 3

Comparison of customer experience for banks versus non-banks

Source: Everest Group (2020); JD Power (2019)



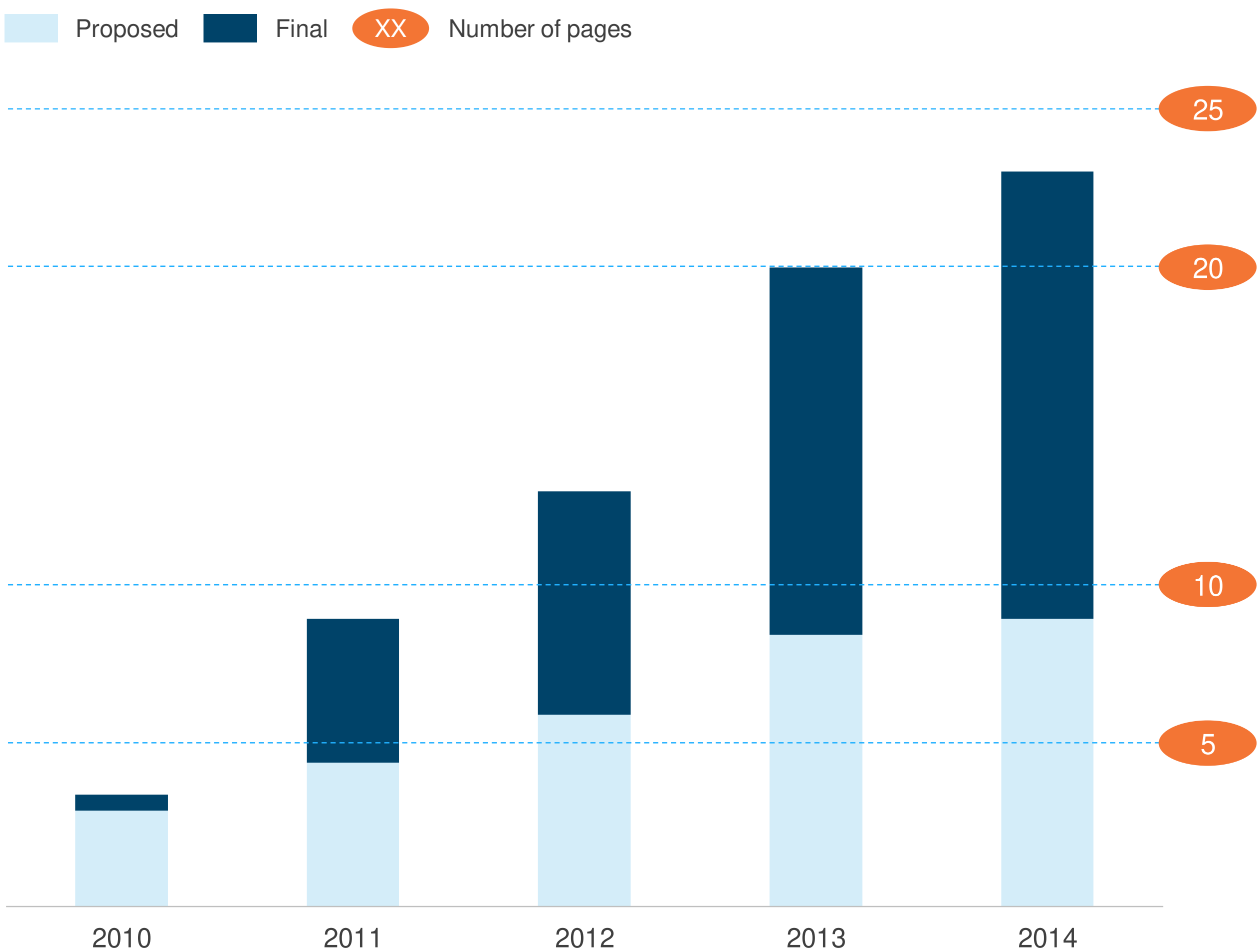
Current state of KYC and AML processes

In the aftermath of the 2008 financial crisis, as banks struggled to keep pace with newer regulatory restrictions, several banks decided to add thousands of FTEs to ensure their remediation backlogs were brought under control. In fact, over the last decade, banks focused most of their resources on reacting to regulatory changes rather than utilizing them to differentiate themselves in the market. Exhibit 4 depicts the number of changes to the Dodd-Frank regulation, which regulates lenders and banks to protect consumers, over five years.

EXHIBIT 4

Changes to the Dodd-Frank regulation over 2010-2014

Source: Everest Group (2020); the Economist (2018)

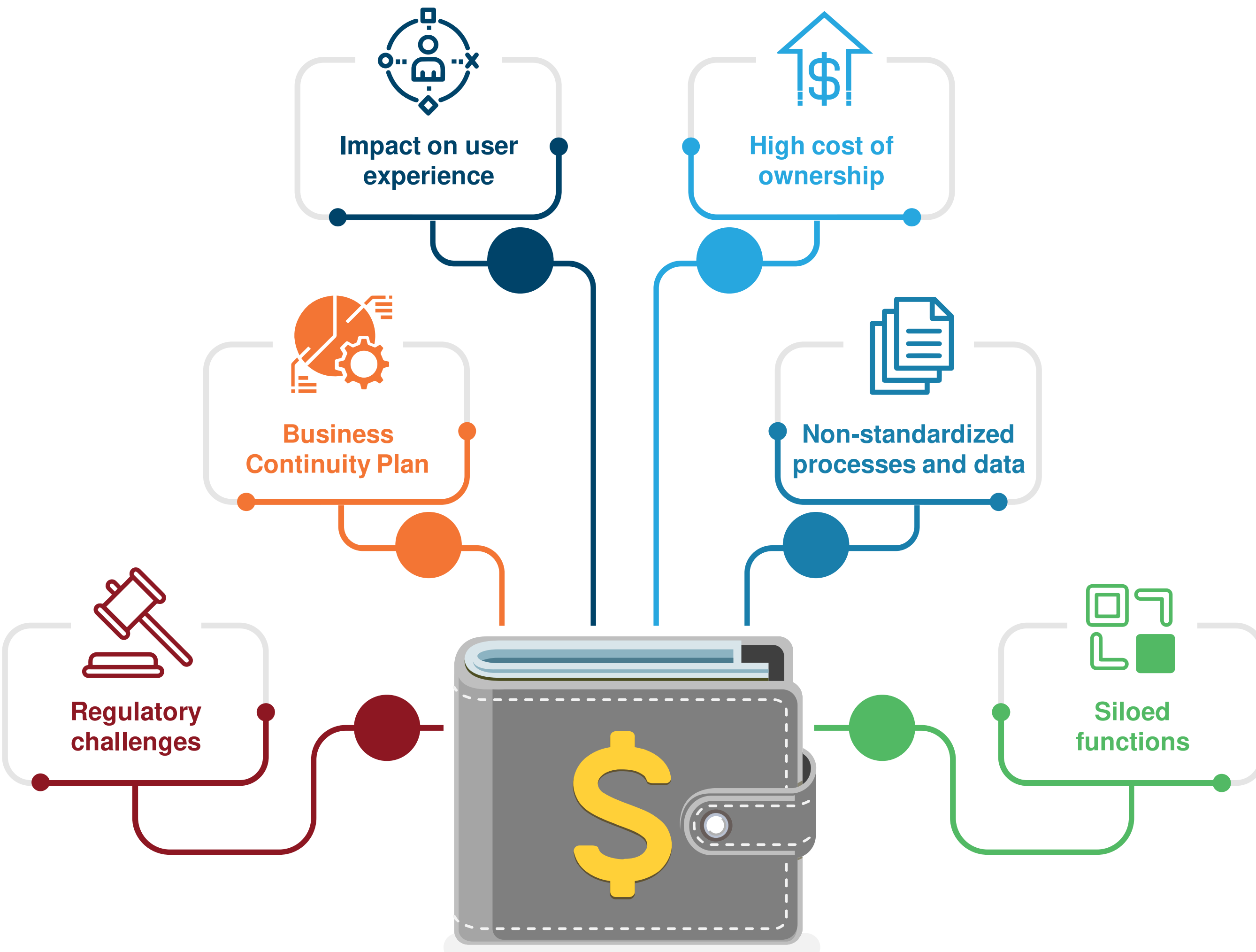


It is no surprise then that, currently, close to 40,000 FTEs globally are involved in manual remediation work. In fact, between 2008 and 2018, the percentage of Citigroup's employees working in compliance, risk, and other control functions increased from just over 4% to 15% of the workforce. Also, France-based banking group, BNP Paribas, nearly doubled staffing in compliance and other control functions by 2018 after it was hit with a mega-fine in 2014. At the same time, manual remediation is riddled with its own set of challenges, as listed in Exhibit 5.

EXHIBIT 5

Challenges associated with manual KYC and AML processes

Source: Everest Group (2020)



Regulatory challenges

Banks have had to comply with several regulatory changes over the last few years to curb instances of money laundering and fraud, as well as to safeguard customer rights. In this constantly changing environment, banks feel apprehensive about overhauling their age-old systems and processes for automation and prefer to rely on hands rather than screens.

Business Continuity Plan (BCP)

In times of uncertainty and unforeseen situations, businesses find it difficult to maintain the level of productivity and output with complete reliance on manual processes. Especially on KYC and AML side, if an uncontrollable event challenges the availability of agents, fraudsters get that small

> "It's the perfect storm: more alerts, more false positives, fewer investigators.
>
> - Jim Richards, the former head of AML at Wells Fargo

window to break through the safety nets. In March 2020, when the whole world was grappling with COVID-19, fraudsters were able to carry out over 2000 phishing attempts and resulted in a combined loss of more than US$1.5 million in the United Kingdom.

Impact on user experience

The manual approach to KYC and AML is highly detrimental for both customer experience and agent productivity. Some of the major pain points that customers experience today are longer turnaround times on decisions, lack of real-time status checks, and multiple rounds of document submission. Agents spend a significant amount of time in scouring through large amounts of data and handling false positives reducing the valuable analysis time on risk assessment checks and complex AML investigations.

High cost of ownership

Banks currently spend a large proportion of their revenue on compliance-related activities. A manual approach further increases this cost in terms of more personnel, remediation work, document management, and data storage. Any lapses in adhering to regulations for these processes/resources can result in heavy penalties.

Non-standardized processes and data

Most banks have separate approaches to KYC and AML processes for each business unit or banking product. As such, customers have to go through the same checks and documentation process multiple times even when interacting with the same bank. The lack of standardized processes also prevents collaboration and data-sharing among the banks' diverse operations.

Siloed functions

A bank's risk & compliance, IT, and product teams work in siloed systems and avoid taking on collaborative projects, keeping in mind the impact on P&L. This makes them miss out on broader engagements that can potentially transform operations.

> "Main challenge is identifying a low-frequency event in a high-volume environment. Technology presents an opportunity to have a richer view of risk levels.
>
> \- Colin Bell, Global Head of Compliance, HSBC

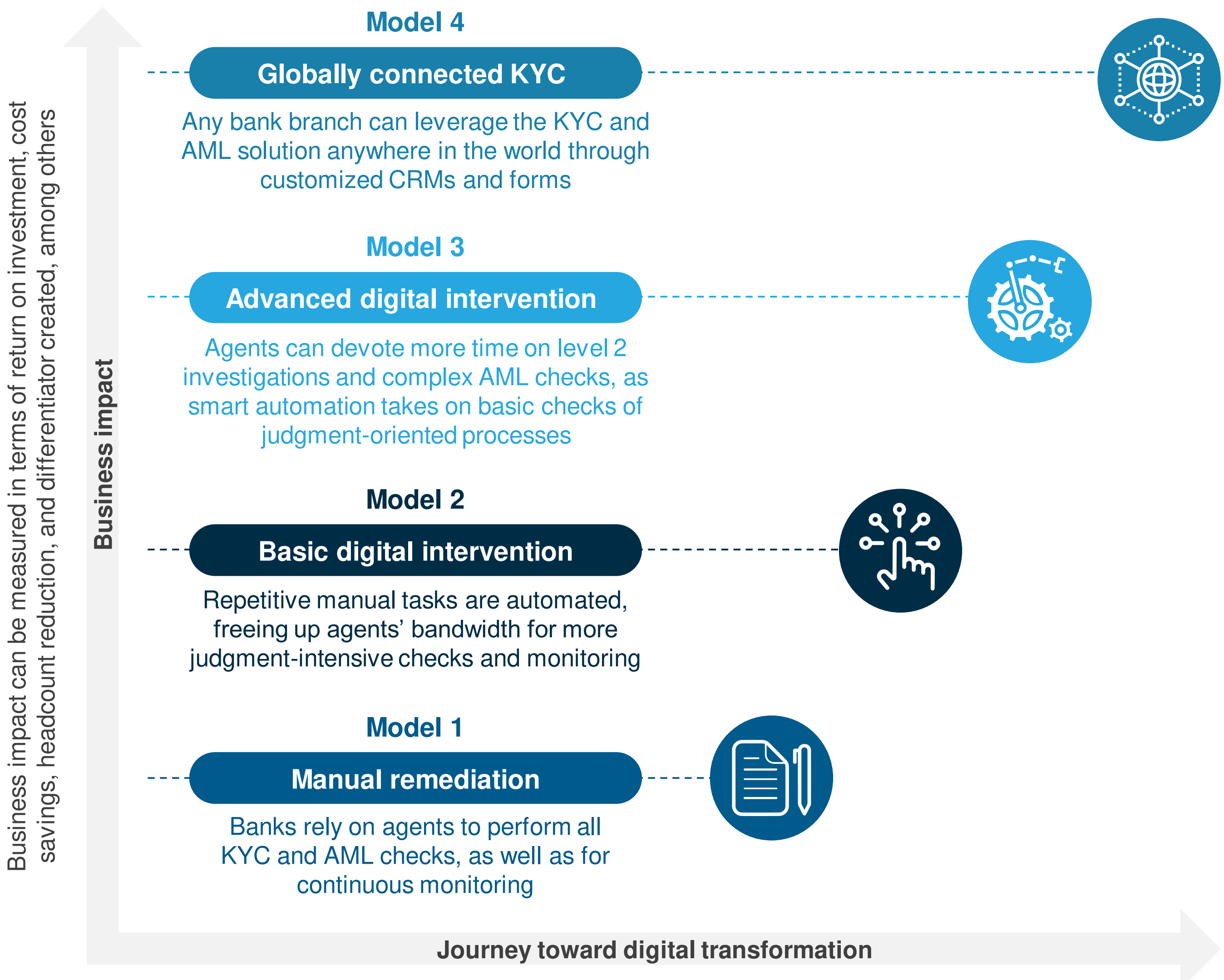
Evolution of KYC and AML processes

Digital interventions in remediation processes are key to succeeding and remaining compliant, while keeping costs low and boosting overall efficiencies. As things stand at present, banks could either take a step-by-step approach, starting with automating simple tasks and then moving on to the more complex processes, or adopt big-bang implementation. We believe that the evolution to a globally connected digital remediation system will consist of four broad stages, with each stage marking an improvement on the previous one in terms of productivity, efficiency, and customer experience, as illustrated in Exhibit 6.

EXHIBIT 6

Evolution of a bank's KYC and AML processes

Source: Everest Group (2020)



As digital intervention increases, complexity of automation (desktop automation, rule-based automation, analytics-driven insights, alert disposition, etc.) also increases

Model 1 – Basic remediation

The first stage in KYC and AML processes is where things stand at present, with most of the tasks being carried out manually. Agents spend hours on data collection and verification, assessments, risk profiling, and screening. Onboarding is a laborious process, with multiple rounds of document submission and status check inquiries. Improper documentation, gaps in background checks, and risk assessment profiling are some of the critical issues identified even after the onboarding process.

> In a 2017 survey, **50% of KYC** cross reference checks in UK were manual and used 5 or fewer data sources for AML/CTF checks

Model 2 – Basic digital intervention

Automation of repetitive manual tasks such as document ingestion, data entry, collation of external data sources, and account opening free up agent bandwidth for more complex activities such as customer screening and risk profiling. This approach significantly reduces the onboarding time, though agents continue to spend a considerable amount of time on Enhanced Due Diligence (EDD) activities. AML-related monitoring and screening processes still remain manual, with substantial bandwidth wasted on false positives. However, compliance reporting activities are automated, which relieves significant burden related to legal requirements and preparation of multiple reports. Projects that implement basic digital intervention usually take 1-2 months, depending on the number of processes being automated.

Per the survey, about **35% of UK** banks used a combination of basic automation and agent intervention to perform KYC-AML checks

Model 3 – Advanced digital intervention

In this model, onboarding processes are completely automated, and customers can expect registration and account opening in a matter of hours, with real-time feedback provided on any misses or issues. Automated tools can extract and collate data relevant for customer risk profiling and assign initial scores, allowing agents to shift their focus from data collection to exception handling and further analysis. Platforms and tools that identify false positives, perform L1 level checks, and dash-board filtered alerts for agents can be implemented. The tools can handle all compliance and KYC processes for a bank in a specific geography but need to be customized and implemented again for other geographies where the bank has presence. Standalone projects to implement intelligent automation solutions for KYC and AML take 2-3 months to complete.

Model 4 – Globally connected KYC

In a globally connected KYC and AML approach, automated tools and solutions can handle global regulatory requirements, data checks, and document management without any need for separate implementation. CRMs for each geography can be customized for agents' use and a single underlying dataset can be used across geographies. Blockchain and AI-driven tools and solutions will enable such functionalities for international banking in the future. Such projects are likely to take a little longer – about 18 to 24 months – to fully go live due to the seamless interactions and accuracy required across front-, mid- and back-office operations.

Different banks leverage different models for their KYC and AML processes. To reach basic digital intervention (Model 2), RPA bots can be deployed to automate transactional processes with less variability in process workflow or data inputs. However, adopting intelligent automation solutions as the underlying technology will help banks jump straight from a completely manual process to advanced digital intervention (Model 3). This model augments analysts' screening and monitoring with insights and scores based on rules and helps reduce manual effort.

Case study

In the following case study, we take a look at how Scotiabank automated its highly manual adverse media search process, bringing in substantial operational and productivity improvements for the organization.

EXHIBIT 7

How Scotiabank transformed its AML program with intelligent automation

Source: Everest Group (2020)

Client details

Scotiabank is one of Canada's top five banks, with 99,000 employees and more than US$1 trillion in assets

Challenges

- Highly manual adverse media search process – personnel in multiples of 100 dedicated to the process
- Limited reach: Agents performed searches on Google to understand the nature of clients' businesses and potential AML exposure to the bank

Requirements

- To improve operational consistency and efficiency, and increase productivity

Solution

The bank partnered with a leading automation provider to implement the following intelligent automation solution

Through its proprietary intelligent automation solution, the provider helped Scotiabank to completely automate the screening process from multiple sources

The solution also provided a fully transparent methodology and decision-making, with automatic documentation of each action

Results

The automated adverse media screening process brought in improvements across several key metrics:

Searches achieved 50% more results

Return on investment observed in less than 6 months

Significant decrease in false positives

Workforce productivity increased by more than 20%

How intelligent automation can help in digital transformation

In this next section, we present potential and promising use cases within KYC and AML and describe how intelligent automation can be leveraged to not only resolve challenges posed by a manual process, but also create significant business impact.

Intelligent automation will help banks automate transactional tasks such as data entry and data collection, as well as complex processes such as due diligence, list screening, and monitoring. Banks need to take the first step in the direction of adopting automation and select a right partner to do so. A number of processes would require manual intervention until automated systems learn, but additional bandwidth would be created from the complete automation of basic tasks. Exhibit 8 illustrates use cases for intelligent automation in KYC and AML processes.

EXHIBIT 8

A heat map of KYC and AML processes depicting potential for automation

Source: Everest Group (2020)

NOT EXHAUSTIVE

Potential of automation in processes Low Medium High

Data sources

Know Your Customer (KYC)		Anti Money Laundering (AML)	
Onboarding	**Enhanced Due Diligence (EDD)**	**Monitoring**	**Reporting**
Document management	Customer screening – Politically Exposed Persons (PEP), negative news, lists, etc.	Suspicious Activity Monitoring (SAM)/SEM	Alert management
Customer profiling and risk assessment	Data stream validation/notification	AML monitoring for Money Service Businesses (MSB)	Compliance reporting
Quality assessment		Trade surveillance	314b data requests/sharing
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Some of the high potential use cases identified above can be further segmented into activities and explored in detail. In Exhibit 9, we take a look at the manual approach currently undertaken for these processes, a possible approach leveraging intelligent automation, and the new approach's business impact.

EXHIBIT 9

KYC and AML processes with high potential for automation

Source: Everest Group (2020)

Use case	Current approach	Approach leveraging intelligent automation	Business benefits
Customer screening (PEP, negative news, sanctions, etc.)	Agents typically spend hours scouring through multiple sources of data to find relevant information pertaining to a single customer. This approach is marked by challenges related to relevance, language translation, and manual oversight.	• Intelligent automation-enabled tools help rummage through data to find relevant articles/information • Translation/transliteration is enabled in such solutions to reduce time spent by agents • Rule-based scoring of each snippet is performed and collated for the agents to derive insights on risk assessment	• Reduction in manual effort by 70%-80% • Increase in coverage of sources by 2X to 3X • Reduction in screening time per customer by 60-70%
Suspicious Activity Monitoring (SAM)	Agents spend significant time analyzing alerts generated by the system; more than 80% of the alerts are usually false positives. This reduces agent productivity to work on actual suspicious activity alerts. A high number of false positives can lead to lapses in catching actual fraud / money laundering activities.	• Tools leveraging intelligent automation can work on alerts generated by the underlying system and create patterns using machine learning to better identify normal customer behavior • Real-time L1 investigation of alerts is carried out to identify parameters for capturing false positives and raise exceptions for agents to investigate further	• Reduction in false positives by 60% • Increase in agent productivity by 30-40% • Reduction in compliance costs by 25-30%

Use case	Current approach	Approach leveraging intelligent automation	Business benefits
Customer onboarding	Agents spend a large proportion of their time entering data into multiple screens and checking data accuracy. An application also needs to pass through multiple departments in a bank, such as front office, risk and compliance, credit, and legal. A high volume of documents to be processed per customer only adds to the turnaround time.	• Intelligent automation fully automates document ingestion, extraction, and entry to multiple screens. It is also able to highlight any data irregularities early on to save effort on the steps ahead • Onboarding approval workflows can be fully automated to reduce the turnaround time • Intelligent automation can help with customer screening and risk profiling based on certain parameters, reducing agent time and effort	• Increase in NPS scoresby 25-30% • Reduction in turnaround time by 50-60% • Reduction in operational costs by 20-30% • Increase in agent productivity by 15-20%
Trade surveillance	While most banks have implemented underlying systems to monitor trades, agents must manually check all alerts and examine linkages to identify any market abuse. Communication surveillance is complex for agents to analyze, with the numerous modes present these days. The biggest challenge faced in this segment is a high rate of false positives.	• Intelligent automation investigates first level of alerts generated to reduce false positives • Tools identify linkage across a multitude of trade trails and provide insights to agents for further investigation • Bots pick up communication trails from various sources and collate conversations for investigation • Intelligent automation-enabled tools automatically generate complete trade reconstructs for audit and help maintain regulatory compliance	• Reduction in false positives by 45-50% • Increase in agent productivity by 30-35% • Reduction in compliance costs by 15-20% • Reduction in errors due to manual oversight by 60-70%

The way forward

The banking industry is experiencing winds of change across domains – retail, payments, cards, and lending – with various market factors pushing banks to rethink traditional ways of doing business.

As regulators try to curb financial crime, KYC and AML processes are likely to get more complex. New digital-first banks and non-banks are pushing the envelope in delivering excellent customer experience along with checking all the boxes from a compliance perspective. Entry of TechFins and FinTechs is adding to the intensifying competition in the industry while banks struggle to meet regulatory requirements. Automated onboarding processes, KYC checks, risk profiling, and screening and monitoring enable for a much faster turnaround and smooth experience for customers and meet the regulatory expectations as well.

Automation solutions are especially a blessing in the present pandemic situation and can help carry out business as usual with reduced agent involvement, remote work situation, and without much overhaul. Now is the right time for any banking entity to begin this journey of automating their manual processes, as it will be a critical factor in determining future market leaders.

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