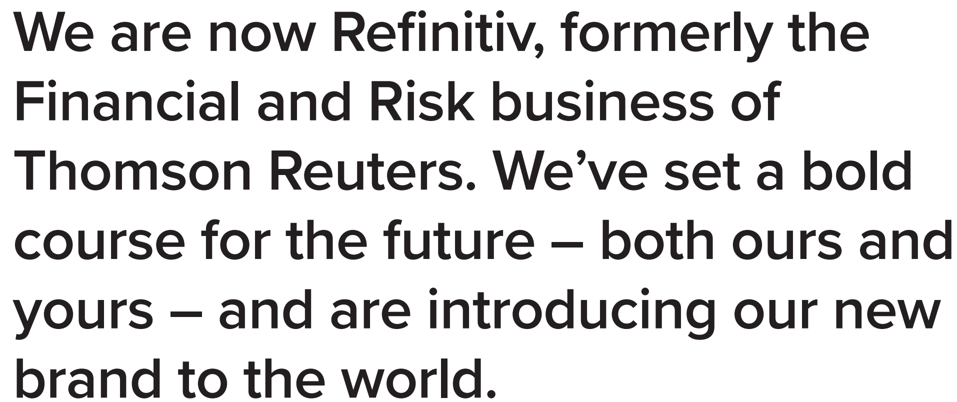

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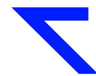

KYC policy variations: Can we achieve industry standardization?

At present there is a lack of harmonized guidance on expectations for implementation of know your customer (KYC) anti-money laundering (AML) laws and regulations (collectively, KYC laws). Issues addressed by the KYC laws in countries around the world are generally consistent, but local expectations for implementation vary significantly. The absence of harmonization in guidance and expectations has led to multiple approaches and interpretations of KYC laws across the financial services industry. While a genuine desire for standardization exists, in reality variances in implementation between countries and, frequently, within a single country are significant – leading to a plethora of ongoing challenges.

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Significant variation in available KYC guidance

There appears to be a growing and genuine willingness on the part of regulators and the financial services industry to move toward standardized KYC processes. Achieving this, however, is complicated by a wide range of available guidance on how to effectively and comprehensively implement KYC laws. Variations in availability of guidance and in the guidance itself have led to multiple interpretations of largely similar laws and regulations within jurisdictions and in countries around the world.

In certain jurisdictions, comprehensive KYC guidance is available. One example is the UK's guidance drafted, published and maintained by the Joint Money Laundering Steering Group (JMLSG). The JMLSG is comprised of the leading UK trade associations in the financial services industry.[1]

The JMLSG states that its aim is "to promulgate good practice in countering money laundering and to give practical assistance in interpreting the UK Money Laundering Regulations. This is primarily achieved by the publication of industry guidance."[2] The JMLSG guidance has become a valuable resource for institutions as it provides detailed guidance how FIs may comply with applicable KYC regulations. The knock-on effect is a greater level of standardization across individual UK institutions' KYC policies when compared to KYC policies from other jurisdictions where less guidance is available.

Where detailed guidance is lacking, FIs may err on the side of caution and raise their KYC standards beyond the KYC laws' expectations. This is driven by various factors, including the fear of enforcement activity, which is unsurprising given the increasing enforcement environment set by global regulators in recent years.

Differing approaches to implementation of KYC laws may also be the consequence of other issues, such as whether or not a bank or other FI is operating under a Deferred Prosecution Agreement (DPA) or other regulatory enforcement mechanism. When this is the case, a Financial Institution (FI) may adopt a higher minimum standard for KYC due diligence when compared to other FIs not operating under a DPA. While this is understandable, it adds complexity to the industry-wide dilemma of achieving standardization in KYC expectations and processes.

As discussed more fully below in the Challenges section, there are significant consequences for both clients and regulated FIs.

Policy differences: real-world examples

Ultimate Beneficial Owners (UBOs)

In Hong Kong, the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (AMLO) has been amended to reflect a significant change relating to UBO, specifically changing the threshold which defines beneficial ownership from the "not less than 10%" to "more than 25%," in line with prevailing FATF standard and international practice, which is 25%.[3] The changes were implemented under section 24 of the AMLO with effect from March 1, 2018.[4] While the amendments indicate a desire to move more in line with the rest of the world, and therefore toward a more common standard, many FIs have been slow to adapt their policies in practice.

In the US, new customer due diligence (CDD) requirements regarding UBO information that covered FIs must collectively[5] take effect in May 2018. The new CDD regulation has already led to questions from banks and other FIs.

Recently published guidance should help to resolve some of the pending questions. That said, while the rule explicitly requires banks to collect UBO information where a beneficial owner holds a 25% (or greater) share in an entity, public comments by regulators have suggested 25% is a starting point and that greater levels of scrutiny may be required in the case of higher risk customers.[6]

Feelings of uncertainly of expectations within the industry are borne out by a Thomson Reuters survey of 438 AML compliance leaders connected with the Association of Certified Anti-Money Laundering Specialists (ACAMS). This survey revealed that approximately two-thirds (62%) of AML professionals are confident their organization can comply with the new Financial Crimes Enforcement Network (FinCEN) rules.[7] This leaves a significant gap for those not yet confident of their ability to comply. Consistent guidance helps to alleviate FI concerns regarding KYC program sufficiency.

Periodic review cycles

Another area where inconsistency is present is time frames to review and refresh KYC data as required by KYC laws. While regulations stipulate that information pertaining to higher risk clients must be refreshed more frequently than lower risk clients, specific guidance as to how often these reviews should occur is inconsistent.

Standardizing the cycle for KYC data reviews across the financial services industry should be simple. Current practice, however, suggests this is not the case. Thomson Reuters research suggests that most institutions refresh high-risk customer information once a year. Time frames for reviews on low- and medium-risk clients, however, vary and are generally between two to five years. For example, one institution may refresh medium-risk clients every three years and low-risk clients every five years, while another may refresh low-risk clients every three years.

Challenges caused by a lack of KYC standardization

Through its various financial crime-related products and services, Thomson Reuters has had the opportunity to review and analyze the KYC policies and related procedures

1 jmlsg.org.uk/
2 jmlsg.org.uk/
3 legco.gov.hk/yr16-17/english/bc/bc07/general/bc07.htm
4 Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Ordinance 2018
5 federalregister.gov/documents/2016/05/11/2016-10567/customer-due-diligence-requirements-for-financial-institutions
6 (2018) Exclusive: U.S. expected to soon release beneficial-ownership rule guidance, Brett Wolf, Regulatory Intelligence
7 thomsonreuters.com/en/press-releases/2017/september/thomson-reuters-anti-money-laundering-insights-report-reveals-a-very-real-fear-of-noncompliance.html

(collectively, policies) with a number of major FIs from multiple jurisdictions including those from the world's biggest financial centers. This analysis has revealed significant differences in how banks and other financial institutions (collectively, FIs) implement KYC laws. This lack of standardization may be tied to availability of related guidance. The lack of standardization has led to a host of challenges, impacting both FIs and their clients.

Thomson Reuters policy analysis work has been complemented by two 2017 KYC-related surveys. In these surveys, Thomson Reuters questioned 1,023 decision makers involved in KYC-related activities at FIs and 1,122 corporate decision makers. The surveys' aim was to better understand the ongoing KYC-related challenges that are experienced by industry players every day.

Challenges for Corporates

Corporates were asked about the types of challenges they experience when asked to provide KYC documents and related information. Thirty-seven percent of corporate respondents selected "different banks ask for different documents and information – no common standard."

Not only do different FIs ask for different information, but according to the survey results, FIs contact their end clients several times during the KYC process. FIs respond that they contact their clients on average four times during the onboarding process alone; with additional contacts are a necessary component of periodic reviews as required by KYC laws. Corporates, however, responded that they are contacted an average of eight times by their FIs during the onboarding process.

Taking into account that corporates have many global banking relationships (the global average is 10) requiring them to supply different sets of KYC documents and information in different time frames, the extent of the problem of lack of standardization becomes more apparent.

The extent of varying information requests and client contact needed for a corporate to establish and maintain a relationship with an FI has resulted in significant effort to achieve a basic process and high levels of frustration for clients.

Our surveys have revealed that some corporates are voting with their feet, with 12% reporting that they had changed banks as a result of KYC issues.

Challenges for FIs

Corporates are not the only industry segment impacted by inconsistent global KYC guidance and expectations. The lack of standardization has added to the complexity of implementing global KYC programs. Related to this is the additional workload of compliance departments at banks and other FIs with increased head counts and related increased costs.

Understandably, there is significant focus by global regulators on financial crime and FIs' financial crime prevention programs. This focus and regulators' identifying deficiencies in FI programs has resulted in huge fines and, increasingly, deferred prosecution agreements. These in turn have drawn C-suite attention to compliance and away from their core business of providing financial services to their clients. In their survey responses, 48% of FIs noted an increase in the amount of time and attention their board of directors and C-level executives devoted to KYC in the 12 months preceding the survey.

One can only surmise that the regulators are also challenged by the varying interpretations of KYC laws and regulations within their own countries and, where they are supervising multinational FIs, across the FI's operations.

Can KYC utilities provide a solution?

Industry KYC utilities enable multiple FIs and their clients to access online platforms that streamline and improve operational efficiencies in obtaining, maintaining and updating KYC data. Knowledge gained from operating KYC utilities may facilitate greater standardization in KYC policies throughout the industry and lead to reduced FI and corporate overheads required to comply with KYC laws.

In addition to improved operational efficiencies, the KYC utility approach leads to a better client experience through reducing FI and corporates' contacts related to KYC data versus the financial services the corporates seek from FIs. FI clients may simply upload and update KYC information on a secure KYC utility portal once. Thereafter, authorized FIs may access this KYC data without constant recourse to the client. The result is an improved, standardized client experience, with fewer contact touch points and faster on boarding times. Data security is also enhanced because clients' KYC data and documentation are provided to and accessed through secure channels.

Thomson Reuters KYC as a Service is built on an interactive platform that streamlines KYC compliance by offering an end-to-end client identity, verification, screening and monitoring service for accelerated client onboarding, refresh and remediation where necessary. Clients' receipt of multiple requests for information is removed, reducing the time, effort and cost of collecting and providing this data, and freeing often scarce resources to concentrate on higher value-add functions.

> *"We estimate that approximately 90% of our time is spent on collecting documents and 10% on actually analyzing them. With Thomson Reuters KYC managed service, we expect to reverse this ratio."*
>
> Richard Lepere, Managing Director at Fund Channel

Conclusion

Banks and other FIs' different KYC policies stem partly from varied jurisdictional regulatory requirements, but also from differing interpretations of the same or similar regulations. Where there is a lack of industry guidance, the differences in individual institutions' KYC policies are more evident and there is a clear argument that all stakeholders would benefit from increased standardization of KYC laws and their related implementation.

The utility model can facilitate the standardization process. Standardization of KYC expectations offers several benefits: Banks and other FIs enjoy improved understanding of what is expected of them in their KYC programs, risk of enforcement actions for failures on the KYC front is reduced, operational efficiencies and reduced overheads for FIs and their clients are achieved. Client experience as it pertains to KYC laws is significantly enhanced with faster onboarding times and decreased contact touch points.

Coordination and cooperation between the regulators, FIs, their clients and KYC utilities will be key to success on enhancing the effectiveness of KYC programs and reducing unnecessary costs and delays in the KYC process. The benefits of standardized KYC processes will likely be significant, positively impacting the KYC landscape for all industry participants.

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