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WHITEPAPER

KYC and the imperative for digital transformation

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Executive summary

For the past two decades, executive teams at tier 1 banks have invested to improve compliance with regulations imposed to fight financial crime. Indeed, many senior industry figures agree that it is a top priority for their institutions; JP Morgan Chase CEO Jamie Dimon, for example, has consistently highlighted the need for regulatory compliance in his annual letter to shareholders.

This emphasis on compliance has seen banks create teams of analysts, often several hundred strong, who follow written instructions while sitting at computers manually searching to discover information about the identity of individuals with control and ownership of companies. This current manual process is, for most banks, hugely expensive, and yet Know Your Customer (KYC) operations have not eliminated financial crime.

Despite investing vast sums, rarely do large discoveries emerge; manual KYC is ineffective in detecting or preventing wrongdoing.

Accordingly, and in the face of increasing competition from digital-first FinTechs, banking executives are now intent on controlling compliance costs through digital transformation. As well as freeing resources for innovation and growth, digital transformation programs enable organizations to offer excellent service throughout the entire customer lifecycle.

This, combined with increasing public pressure on establishing beneficial ownership of assets, means the next area of focus for efficiency-conscious and digitally focused executives is now KYC.

When contemplating the digital transformation of KYC, it's important to note that it is not simply a technological challenge; if it were, every bank licensing a new technology would be on an equal footing. Rather, the advantage lies with the banks finding ways to maximize the opportunities technology offers.

The collaborative work of denying dirty money entrance to national economies is creating a community of banks, regulators, information suppliers and tech companies, the natural progression of which is an increasing flow of information between entities.

The outcome of industry collaboration is a digital ecosystem supported by tech companies and consulting firms with domain expertise, all sharing knowledge so that national and international economies are fortified and able to sense and respond to attempted financial crime in near real-time.

This paper seeks to help those banks intent on making a success of digital transformation by considering KYC in terms of their culture (people), how they work (process), and what they can acquire (technology). It is in these areas of overlap that banks have the chance to create real, sustainable value.

Manual KYC is broken; digital transformation is the fix

For banks, performing KYC due diligence on corporate customers involves employing hundreds of analysts. These analysts must access multiple external sources of information to identify ultimate beneficial owners (UBOs), establish corporate hierarchies, screen for politically exposed persons (PEPs), and crosscheck sanctions lists.

The productivity problem

Measured by KYC cases completed per analyst per day, current productivity is low, and the process is expensive. Automation turns this productivity problem on its head, allowing a significant percentage of cases to complete as straight-through processing (STP) with fewer mistakes and to a higher quality. The result is more customers onboarded every day at lower costs.

Automation also creates greater capacity from existing KYC resources, giving banks headroom to grow their customer base and to tackle KYC refresh and remediation projects that would otherwise be outsourced.

The accuracy problem

The nature of current KYC processes means information is typed manually or 'copy/pasted' from one application to another. Given the level of human involvement in the process, it can be fraught with error. To reduce the resulting risk of poor compliance, banks employ additional quality checkers (QC) and quality assurers (QA).

Adding more humans to the mix does not dilute individual capacity for error, however. Since technology is capable of deeper, faster, and more comprehensive data discovery than human experts, it is arguably far better suited to finding information in the external sources relied upon for KYC. This data can also be plugged into a bank's Client Lifecycle Management (CLM) system through Application Programming Interfaces (APIs) to avoid manual keying.

Re-engineering manual KYC processes therefore results in more thorough due diligence, higher productivity, and a reduced need for QC and QA resources, while also improving quality scores.

The job satisfaction problem

For the people tasked with completing KYC, the routine nature of the work can lead to low employee satisfaction and high staff turnover rates. With the right technology in place, however, staff retention can be boosted; automation allows a percentage of KYC due diligence cases to be auto-decisioned, freeing analysts to pivot to more challenging and rewarding tasks such as exception-based decision-making.

The manual sourcing of information can also cause frustration; when analysts cannot easily find information they need, they may push work back to their colleagues in the front office, asking them to reach-out to prospective customers for information. This offloading:

- creates tension between teams in front and middle offices
- adds time to case completion and delays onboarding
- jeopardizes the service expectations of new and existing customers
- undermines banks' strategies to deliver excellent service and reduce points of friction.

Automation is the obvious solution; it drives fast and comprehensive data discovery to make KYC operations teams self-sufficient, leaving front office teams to focus on building high value client relationships.

The procedure problem

Despite efforts to document the KYC process in detail, the reality is that analysts do not always follow written procedures. This undermines risk controls established with regulators as the baseline for compliance. In contrast, automation helps banks create and maintain consistent, auditable and repeatable processes which enforce risk controls.

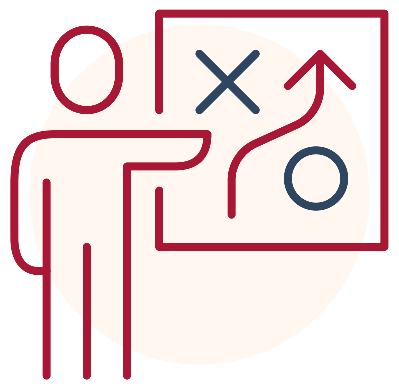
As a manual process, KYC is brittle and difficult to change. Operational control procedures need to be redefined and rewritten, and large teams retrained. One goal of digital transformation is to create agility, so changes can be made quickly and are easily adapted to changing circumstances. A proven automation technology offers banks agility, so KYC operations are active participants in continuous improvement programs.

Setting the direction for success

Having too narrow a focus for automation, such as only automating one or two steps of a process, rarely delivers the best outcomes. Successful technology deployments consider all KYC stakeholders, including customers, operations, risk, and front office. The greatest success comes when operations, tech and transformation teams work together to reengineer a process end-to-end, with the ultimate goal of creating a beneficial impact for customers.

The challenge is therefore to use technology to change how a bank operates in order to optimize the customer experience.

The big picture approach



Many banks are currently undergoing enterprise-wide digital transformation programs, and KYC automation should be considered part of this broader transformation program.

This approach means key change elements such as executive sponsorship, transformation teams, and IT teams become available to the project, and the development of a new KYC operating model can then be linked to other programs and their constituents within the bank.

Taking a broader view can also provide perspective on issues which may not be immediately apparent to an operations team focusing on productivity only: a Chief Data Officer and their team will likely recognize KYC as a point where fresh and valuable information can enter the bank for use in a range of data-driven initiatives, for example.

Recognizing individual contributions

Recognizing and rewarding the contributions of people working towards successful KYC transformation gives individuals a tangible goal to drive for.

Management consultants McKinsey observe that “generous and specific financial incentives are one of the most effective tools available for executives to motivate employees.” McKinsey’s research found that companies that tied financial incentives to transformation outcomes “achieved almost a fivefold increase in total shareholder returns (TSR) compared with companies without similar programs.”

At present, a third of companies fail to offer financial incentives to those at the center of digital transformation. It’s therefore advisable to set goals and metrics of their success at the outset of a KYC transformation project.

The table on page 5 illustrates some ideas for goal-setting and measuring success.

Table 1 **Set goals and measure value of KYC transformation**

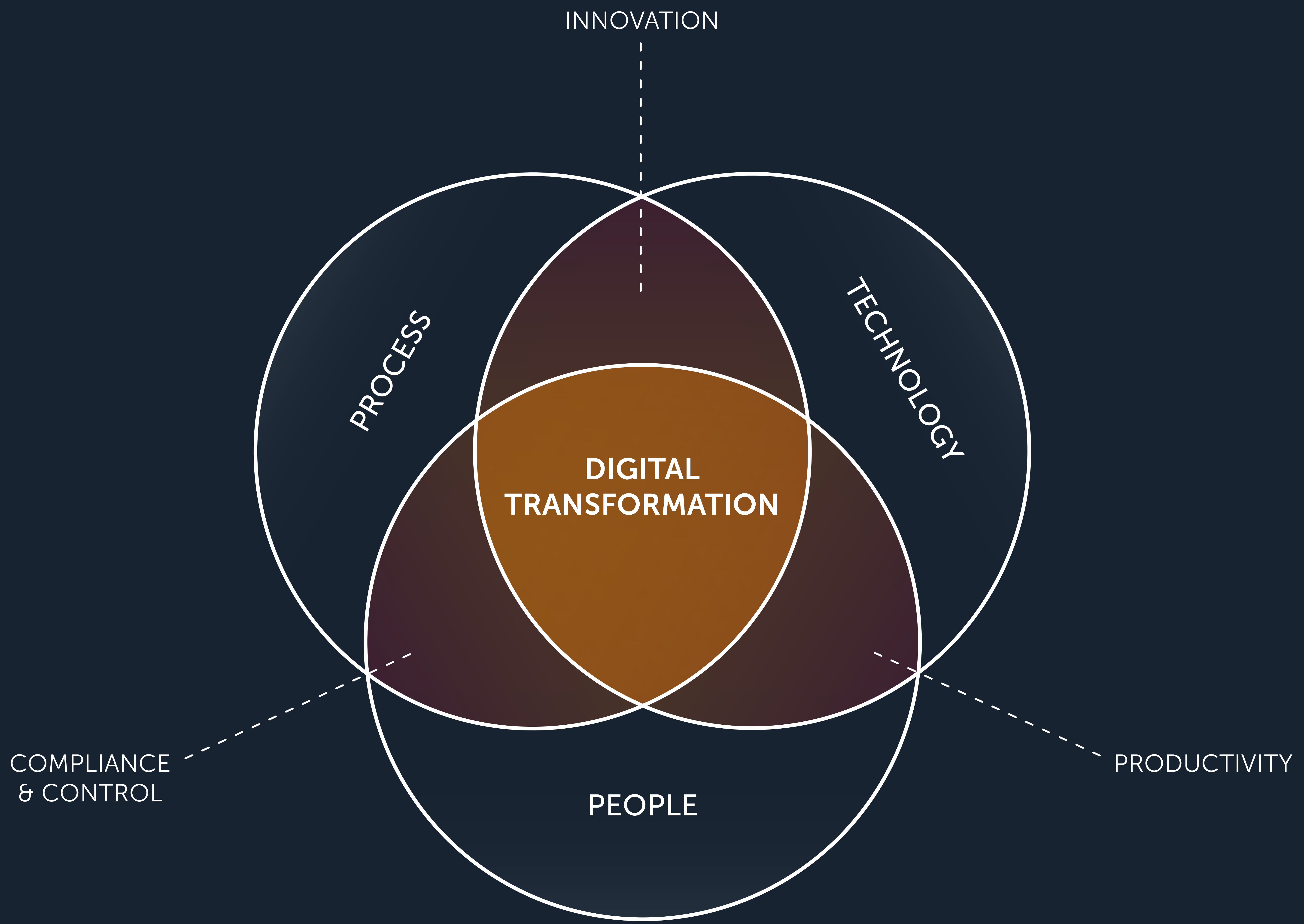
Goal	Success metrics
Improve KYC analyst productivity	Increase number of cases completed per analyst from X a week to Y a week Reduce time on case from X to Y Reduce elapsed time on case from X to Y
Create a consistent, auditable and repeatable KYC process	Lift QA and QC scores by X percent Improve audit review scores by Y percent
Reduce KYC operating costs	Achieve a X percent reduction in cost of KYC cases within 12 months of process implementation
Improve retention of top KYC analysts	Improve employee satisfaction scores by X percent Reduce attrition of KYC analysts rated within the top 50 percent by Y percent
Establish risk management indicators for KYC teams rather than volume based KPIs	Achieve QA score of X and QC score of Y
Achieve straight-through processing (STP) where feasible	Achieve X% of auto-decisioned cases within 12 months of implementing the new process
Reduce risk through deeper, faster and more comprehensive discovery of facts pertinent to KYC	Automation uncovers X percent of the data attributes required in KYC due diligence
Reduce outreach to customers for information across all KYC journeys	Customer outreach incidents reduced from current level to X (acceptable practice)
Automate KYC Refresh to demonstrate commitment to compliance to Board and Regulators	Reduce number of client reviews past review date by X percent
Ensure best fit for KYC within a broader client onboarding digital operating model	Improvement of X percentage points in customer satisfaction surveys
Support the bank's strategy for digital transformation of customer-centric processes	KYC automation integrated into the broader customer onboarding journey such that KYC receives digital information from upstream systems and provides information to downstream systems with minimum human involvement

People. Process. Technology.

Consideration of the intersections between people, process and technology is a proven approach to planning a digital operating model, and creating the changes required to transform an organization.

Finding the right balance between the three is key for success.

Exhibit 1 **A digital KYC operating model**



People and technology

Between people and technology lies untapped productivity

Poor productivity and mounting operational costs are often a catalyst for automation, so examining the intersection between people and technology offers a good starting point for digital transformation.

In manual KYC, analysts spend significant time finding data, and far longer analyzing the information they discover. Technology can replace most of this human effort: KYC data providers are undertaking their own digital transformations, meaning that information is increasingly available in a digital format and accessible via APIs, facilitating machine-to-machine interaction with no human involvement.

However, a simple machine/person substitution fails to address the productivity shortcomings of the existing manual process. Successful KYC transformation should result in a value-add position for KYC analysts which focuses on their experience and judgement, such as analysis of high-risk customers.

Designing work to encourage enquiry and exploration radically improves job satisfaction in KYC, particularly when analysts are motivated by the link between their work, society's need to protect itself against financial crime, and the bank's goal of accelerating customer onboarding to deliver excellent customer service.

Process and technology

The intersection between process and technology is a source of innovation.

Technology offers the opportunity to rethink the way KYC analysts work and the work they do. Because technology offers new efficiencies in discovering and analyzing data, some banks see an opportunity to fully automate KYC and achieve straight-through processing (STP). For the sake of clarity, here we define STP in KYC as the ability to process tens of thousands of records and have a moderate to high percentage complete successfully without analyst interaction required. Factors driving the percentage of automation achievable are unique to each bank.

Emerging external data sources and advances in how existing suppliers deliver data means that careful planning at the intersection of process and technology gives banks enormous potential for continuous improvement in their drive to maximize rates of STP.

Automating KYC as a digital process creates a strong foundation for new and better business-as-usual operations: lifting STP rates is a prime example. Achieving higher rates of STP may be triggered by new regulations, new data sources, innovation from existing data suppliers, or even new capabilities released by an automation vendor.

While unlikely that 100% of a bank's customers are suitable for STP, the process for those which require an analyst's attention can be improved by decoupling the work done by machines and that done by human experts. Information discovery and analysis can be batch processed and the results reviewed by analysts with high value assessment and decision-making skills, for example.

Another key benefit of technology for KYC processes is its repeatable nature. As regulated entities, banks must be capable of demonstrating to a regulator that they operate within risk-based controls. In a manual process, demonstrating that analysts consistently follow these controls is almost impossible. With appropriate technology, creating a tamper-proof audit trail of all work undertaken in a digital process is straightforward.

Automation technology addresses major bottlenecks and facilitates STP

Automatically accesses, logs in, finds and retrieves data and documents

Automatically joins, de-duplicates and merges entities discovered at different sources

Enriches customer records by finding missing attributes from other data sources

Improves data source search capabilities to automatically identify the target entity

Eliminates unnecessary user interactions (UIRs) by analysts

People and process

Ensuring regulatory compliance begins at the intersection of people and process

Risk and compliance staff are often frustrated when analysts fail to follow their instructions or attempt to circumvent their controls. Enforcing such controls is difficult in a manual environment.

A well-designed digital process helps analysts deliver high-quality due diligence by allowing risk controls to be embedded directly into a redesigned KYC process. For example, a control stating 'check information source X for facts of ownership, if these facts are not available, check source Y' can be enforced in code so that each time KYC is applied, due diligence is undertaken as intended by the risk and compliance team.

As automated processes define and standardize how analysts work, new hire training is simplified, allowing banks to adjust their KYC team capacity as required. The process and its underlying technology shields new hires from details of which information sources are used and how these are accessed, freeing them to focus on exception-based decision-making.

This flexibility is welcomed by banks, who rely on trusted service providers to handle bursts of activity created by special projects, acquisitions, changes in regulations, or the need to refresh a significant percentage of their customer book.

Several banks are investigating perpetual KYC (pKYC) as an event-driven approach to check if facts previously relied on to make a risk decision have changed and whether the change is material to the risk decision. Some of the impetus for pKYC comes from data vendors adopting push technologies in their database systems; they can now track which banking customers have previously accessed records about an entity and alert those banks when the data in their system changes. Processes automated today can be reconfigured to respond to alerts from data vendors allowing banks to plan when and how they investigate the potential value of pKYC to their own operations. As important as this external stimulus, many banks recognize changes to their internal data, such as the submission of a Suspicious Activity Report (SAR) or change of SIC code, as a valuable prompt to consider review KYC.

End-to-end architecture

With widescale digital transformation a top priority for banks, KYC is of increasing interest to a range of stakeholders.

Operations
Recognize their need to increase productivity

Risk
Need assurance of high-quality, compliant KYC

Sales
Want quick and efficient KYC with minimum delays in customer onboarding

Data teams
See the value of re-purposing information gathered from external sources to reflect changes in internal data

An end-to-end systems architecture provides banks with the means to align work with customer needs while meeting their regulatory obligation to maintain a comprehensive view of risk. Deriving full value from their transformation programs means connecting digital KYC technology with other systems.

The goal is for data to be captured once then reused multiple times: data ingested by the KYC process can then be used by data teams to enrich data products provided to the customer facing business units responsible for customer service and revenue growth. Examples of teams that could benefit include:

- Relationship management
- Business development
- Client service
- Product support
- KYC
- Transaction monitoring
- Credit

While individual system components may differ between banks, this convergent thinking is producing an end-to-end architecture that supports onboarding and lifecycle management while also ensuring a high return on data investments initially made in KYC.

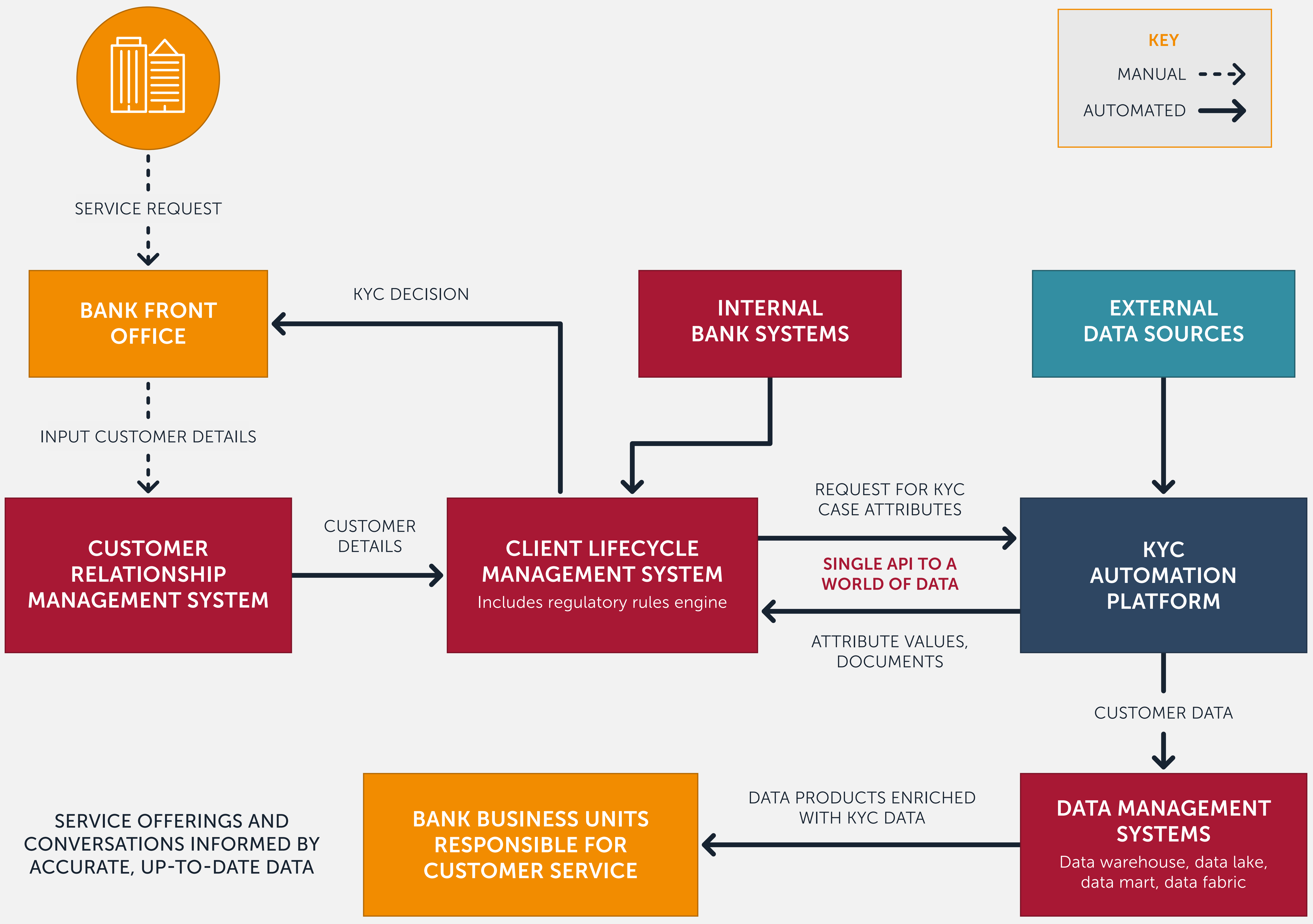
Exhibit 2 shows system components and data flows that commonly feature in these architectures. It is not intended to be fully comprehensive, as banks will plug-in other components serving a range of automation projects across their operations.

Thanks to the support and coordination they offer to marketing and sales teams in winning new customers, over the last decade Customer Relationship Management (CRM) systems have become deeply embedded within banks' systems architecture.

Now, intent on defending revenues from digital-first fintechs by making the customer their primary focus, progressive banks are putting Client Lifecycle Management (CLM) systems at the center of their architecture.

Integrated with multiple internal systems, the CLM is a central hub to coordinate every interaction with customers and ensure the bank provides excellent customer service throughout each business relationship. The CLM includes a business rules engine, which is used to enforce risk policies, and workflow automation to speed-up work in multiple business processes.

Exhibit 2 **An example of end-to-end system architecture supporting onboarding, KYC and lifecycle management**



What does a KYC automation platform do?

Connect to sources of KYC data trusted by global banks

Unwrap corporate structures

Create and visualize corporate hierarchies

Identify and verify beneficial owners

Create a digital KYC profile for each corporate entity submitted for KYC processing

Capture documents from their original sources

Maintain lineage between data attributes in the digital KYC profile and their origins in source documents

Create a dynamic audit trail of all work completed in KYC due diligence, including process automation and analyst actions

While a CLM is vital to strategic initiatives that drive growth, as regulated entities with responsibilities to protect national economies against financial crime, banks must adopt a risk-based approach to doing business with prospective and existing customers: CLMs alone do not fulfil this need.

Assessing risks across hundreds of thousands of business relationships requires access to a world of external data, including from regulators, company registers, sanctions lists from multiple jurisdictions, and vendors of premium data. A KYC automation platform such as Encompass fulfils banks' needs by connecting to the external data sources necessary to taking a risk-based approach to business.

The world of external data is made available to a CLM through integration of a single Encompass API, helping banks link their internal and external data hubs. Management consultants McKinsey recommend the value of this approach to data:

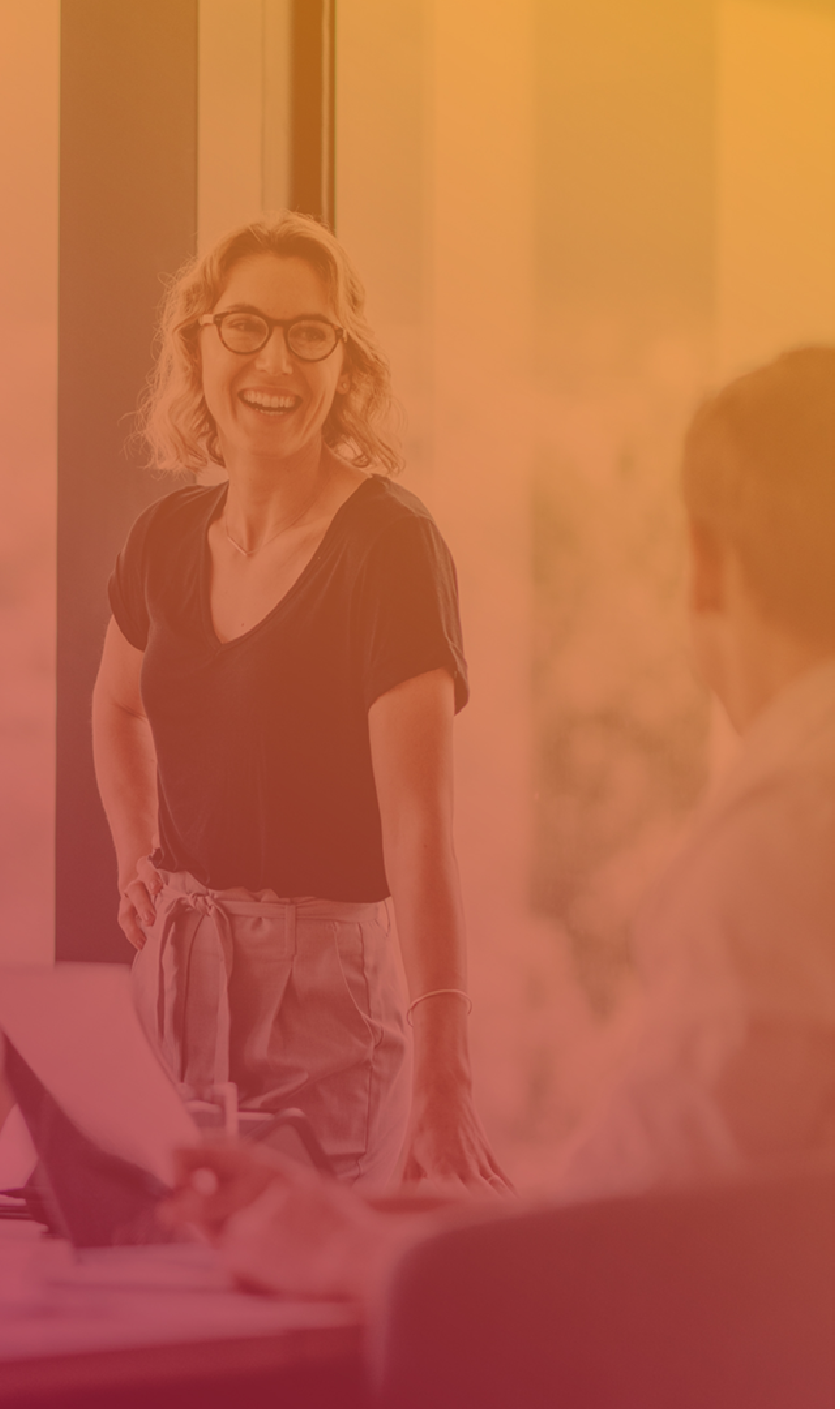
> "Organizations that stay abreast of the expanding external-data ecosystem and successfully integrate a broad spectrum of external data into their operations can outperform other companies by unlocking improvements in growth, productivity, and risk management.

KYC success is the foundation of 21st century banking. However, the reality of operating in multiple jurisdictions, each with their own rules, brings significant challenges. KYC is data-driven, and as the data required by KYC is increasingly digitized, banks have an opportunity to automate while supporting strategic initiatives to make the customer the central focus of bank operations.

Automation of KYC due diligence delivers numerous benefits, including a reduction in human errors and omissions, leading to increased efficiency through reducing the cost of KYC and improving the quality of work delivered by analysts. Importantly, automation supports banks' customer service improvement strategies by accelerating the client on-boarding process, resulting in a positive impact on revenues. Also improved is adherence to compliance rules, reducing potential for regulatory intervention; it creates the foundation for simple, ongoing monitoring of customers and the potential to adopt pKYC.

A goal of the broader program of digital transformation being pursued by executive teams is to overcome barriers to growth imposed by manual processes that are highly capital intensive, and which do not scale even with increased labor inputs. Automating KYC improves capacity for scalability.

A KYC automation platform such as Encompass does the heavy lifting of the data sourcing, retrieval, and collation of the KYC due diligence process, from onboarding and throughout the lifecycle of a business relationship. When integrated with a CLM, this allows banks to create and maintain a comprehensive view of risk.



Towards a digital ecosystem: the next step?

A bank's work to transform KYC into a digital operating model can be viewed from the broader context of the national and global work of protecting economies and financial systems from criminals attempting to launder money or finance terrorism. The need to protect economies against financial crime and the wave of digital transformation sweeping the financial services sector may engender the emergence of a digital ecosystem.

Digital transformation programs within banks equip them with the agility needed to make adaptions as criminals evolve and adapt their offences, and defense against highly organized criminals demands that protections are system wide. However, system wide defenses demand high degrees of connectivity and collaboration, such as banks communicating with each other and with regulators to erect a 'sense and respond' capability, which not only protects the bank against attempted financial crime but alerts other banks to an attempt.

Banks partner with an array of companies in this ongoing battle, including information vendors, systems integrators and technology innovators such as Encompass. This cooperation sees multiple parties unify around the common goal of defending economies against the corrosive impacts of financial crime.

In a report for the World Economic Forum, Michael G. Jacobides of the London Business School observes that digital ecosystems "consist of interacting organizations that are digitally connected and enabled by modularity and are not managed by hierarchical authority," and that "organizations come together by co-specializing with each other, creating bonds that engender collaboration, without excluding competition."

Existing digital technologies and business transformation programs make possible a near future where banks access information on-demand from a vibrant data economy. They will be empowered to analyze this in context of their proprietary, transactional information to identify and nullify emerging threats, while using machine-to-machine communications to alert other institutions to attempted crimes in near real-time.

About Encompass

Encompass transforms regulatory compliance and customer onboarding for firms with KYC automation.

Our advanced technology, unrivaled data coverage and industry expertise help clients to safely grow their businesses and fight financial crime.

Across the globe, our customers include leading global banks and financial institutions, including Wolfsberg Group members. We have strategic alliances with a range of trusted data, technology and service providers enabling integration into existing workflows and systems.

Find out more at encompasscorporation.com.

About the author

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President, North America

Alex drives business growth in North America, working with customers, partners and the Encompass team to transform KYC with automation in financial institutions and other regulated entities.

Joining in 2012, Alex has held Executive responsibility for business functions including Customer Success, Operations, Marketing, Product and Delivery. From 2015 to 2020 Alex was based in Glasgow with the launch and expansion of the UK operation, before taking up leadership of the North America business.

Alex also serves on the board of The RegTech Association and works with the Business Information Industry Association. Prior to Encompass, Alex worked in innovation and marketing roles for coaching, leadership and technology businesses in APAC.

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KYC Transformation Director

Howard works with Tier 1 banks to digitally transform their KYC onboarding and refresh processes. He has held a number of executive-level operational roles with a major global bank including leading their wholesale KYC Onboarding and Refresh functions. His most recent role prior to Encompass was as Managing Director, Group Financial Crime Operations at Barclays Bank, where amongst other functions, he was accountable for leading KYC Remediation of Corporate and Investment Bank Client records to FCA committed timeline.

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KYC Transformation Director

An experienced financial services leader, Jo has held senior positions at leading banks, including HSBC, Westpac and ANZ, and been responsible for a wide range of functions, including front office and client support, client onboarding and regulatory compliance and reporting.

At Encompass, she is part of a global team helping customers get the most out of transformation initiatives.

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KYC Transformation Director

Darren has had a varied management career within several high-profile investment banks, such as UBS, Deutsche Bank, and Citigroup. At Encompass, he is a key figure in the KYC Transformation team, based in Sydney, whose knowledge of the operations functions of financial institutions supports both current and prospective customers.

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Catherine **Warren**
KYC Transformation Director

Catherine has extensive experience in compliance and risk management for top banks. Catherine, who has held senior roles at Bank of America and PNC, works as part of the global KYC transformation team at Encompass, making a difference to customers and their processes.

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