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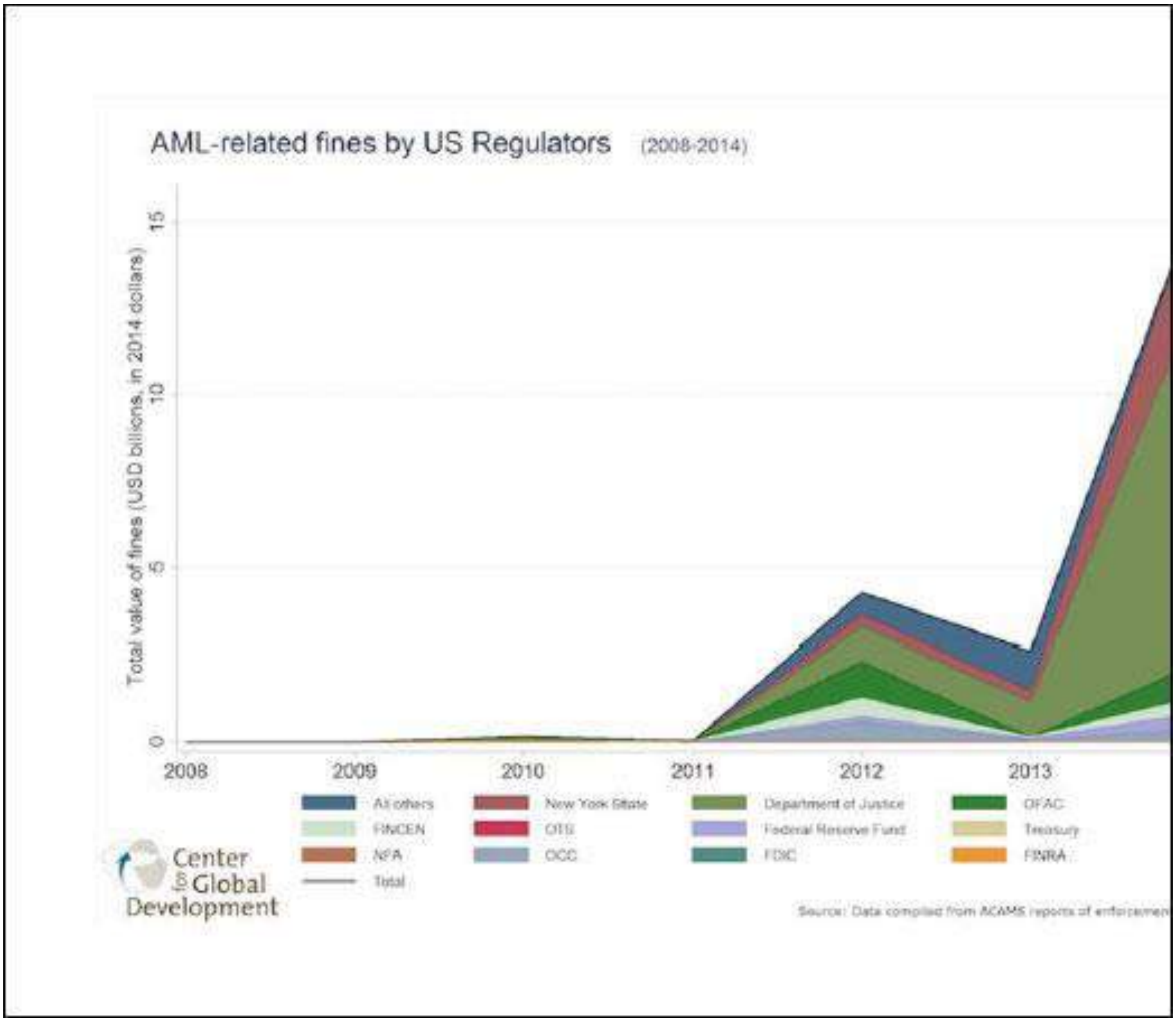
Whitepaper

Cost of KYC List screening for AML Compliance is no longer out of reach

How small and medium size financial entities can cost effectively add KYC List screening into AML regimes

Background:

Prior to 9/11 adequate AML compliance and/or outright non-compliance had been the *Business As Usual* for most banks and financial institutions. The Financial Action Task Force (FATF), a body which now includes 37 member nations, was still in its infancy prior to 9/11. It wasn't until 2012, that the FATF actually codified its recommendations and interpretive notes into one document.



This was about the time we saw a shift with the various regulators to increase the compliance framework along with imposing stricter fines. These fines forced a shift for most major financial institutions, who were lackadaisical with their compliance regimes, to realize there was a bigger cost of reputational risk. While the total cost of just the US's regulator fines increased to over $15B annually between 2011-2014, its is now over $60B in 2016. This however, its small in comparison to reputational loss due to lack of customer confidence and industry acceptance. For example, Western Union, which was fined in 2012 for $186 million, saw their stock price in

Cost of Compliance =
(Cost of Internal Compliance Infrastructure) + (Cost of Fines)
+ (Cost from Loss of Reputation)

Where (1) Cost of Internal Compliance Infrastructure refers to the total hard and soft costs for running the compliance apparatus within the organization, including human resources, systems, controls, audits, and loss / delay in business (hence revenue); (2) Cost of Fines refers to FinCen, FINTRAC, Austrac, and other governing body related fines due to inadequacies in operating the internal compliance infrastructure; and finally (3) Cost from Loss of Reputation refers to the loss, both in sales and shareholder equity, that a business suffers upon discovery of lax compliance standards, implying

November 2012 go from $18 to $11 over a 2 day period. It took over 18 months for the stock price to recover. This is why, now, the major banks and financial institutions are reluctantly willing to bear that type of shock to their stock price. The top-down risk of reputation loss is greater (and a great motivator) than any regulatory fine.

So what about the Smaller and Mid-size Financial Institutions, Money Service Businesses (MSBs), and other financial services related entities that are required to comply by AML/KYC regulations? Mostly into 3 types:
a) have exited cross-border transactions and other high(er) risk businesses due to regulatory risk,
b) continue to operate without compliance framework, or
c) have implemented rudimentary home grown or grossly inadequate 3rd party systems on the probability of a fine remains low as the regulators are more focused on the larger player.

The common theme for most is that the cost of compliance continues to be greater than Cost of

Fines. This directly relates to the fact that systems and vendors DO NOT really exist to services the needs of this market! Most major vendors and systems are designed for and priced for the Big Banks who have pricing power driven by need for “over compliance” to avoid Reputation Risk.
Smaller Banks, MSBs, and other financial services entities are faced with systems/solutions that are too complex to integrate, too broad in scope, and/or too expensive, or systems/solutions (build or buy) that are affordable, but light weight, incomplete and inadequate.

In Summary, since 2012, market dynamics are changing. The probability of any given regulator to fine a small to medium size entity has increased given the larger entities are mostly compliant now. These smaller entities can no longer survive by using inadequate AML tools for the base KYC List Screening function.

Introduction:

In today’s fast pace changing of AML regulatory requirements, many small and medium size Financial Services and related companies are facing increased scrutiny and looking for cost effective and efficient tools to satisfy these regulatory bodies. The threat of not having appropriate AML regimes in these entities is ever increasing and many times results in “de-risking” even when they are in-place. This is a result of many financial institutions “exiting” vast lines of business to decrease risk and easily comply with these changing regulations. This in turn translates into the cost of “Reputation Risk” versus “Audit Risk”. Meaning, the cost of loss of Reputation or inadequate AML regimes translates directly into compliance penalties and/or “de-risking” of bank accounts.

The key piece of an effective AML regime is Know Your Customer (KYC) screening. This KYC screening involves searching known public databases and lists for onboarding and ongoing monitoring. These databases and lists are published by regulatory bodies, government, and Law Enforcement. These include the FATF, OFAC, SDN, UN, INTERPOL, FBI, US Treasury, HM/FCA, Interpol, and literally tens-of-thousands of other Terrorist List, Criminal Lists, Sanction lists, Watch lists, No fly lists, open data lists, criminal lists, and Politically Exposed Person (PEP) lists.

As a result, many of these small and medium size Financial Services entities have are being cooped to ensure they have appropriate AML regimes in-place for KYC Screening. In many cases, this produces a tug of war between the cost of compliance over risk of non-compliance as it relates to being a profitable business. These costs are usually related to over developed AML tools by the incumbents that are too complicated for small and mediums size businesses to use even at the exorbitant pricing. For these small and medium size Financial Services entities, the existing incumbents within the KYC List screening space typically range between $5,000 to $10,000 USD. When examines these services, they usually have many add-ons and features that will never be used.

Lastly, the KYC screening services must have the flexibility for multiple modes of solution delivery that include: a) on demand screening via web UI, b) bulk screening via batch processing, and c) integrated screening via Open & Extensible API for 3rd party and in-house system interfaces. While list aggregation and normalization is the primary requirement towards meeting the minimum KYC Screening, the flexibility and 'smarts' for access to a KYC Screening engine greatly improves the efficiency of the overall compliance process which is necessary without the exorbitant costs typically associated with the existing incumbents.

This paper will explore the unique opportunity this situation provides for these small and medium size Financial Entities. We'll explain;
- A sampling of various databases and lists as they relate to regulatory bodies, government, and Law Enforcement
- Normalizing these lists to be accessible though the web
- Summary of Case Studies on the ways to access KYC Screening
- Conclusion and Next Steps

Databases and Lists

Who are these regulatory bodies, government, and Law Enforcement that publish this?

Regulatory Body, Government, Or Law Enforcement	Database or List
United States - US Treasury - FINCen - Each state Financial Regulator (51) - OFAC - CIA - FBI - SDN - Office of the Inspector General	Sanctions Money Lauders Terrorists Criminals No-Fly Wanted Abuses Weapons Narcotics Non-Proliferation Exclusions PEP

European Union	Restrictions Sanctions Terrorists PEP
United Kingdom - HM	Terrorists Sanctions PEP
Switzerland - State Secretariat for Economic AffairsEuropean Union	PEP
CANADA - FINTRAC - OSFI	
Australia	- AUSTRAC

Currently there is no “one” public regulatory body, government, or law enforcement which is compiling a list of all known sources of Terrorist, Sanctions, Criminals, Watch List, Politicians, or Key Directors, Management and Shareholders or International Organizations. These some of these regulatory body, government, or law enforcement and the associated databases and lists include;
The above is a small sampling of the lists and databases. When one considers that there are over 220 countries in the world, with only 37 that are actively involved in the FATF and over 180 countries agreeing to put in a AML regulatory regime within the next few years, these lists and databases will only get bigger and more complex.

Normalization of Databases and Lists:

Given that there is no one standard format for the databases and lists, one must consider how this data is to be normalized so that it can be effectively searched to ensure that the KYC screening part of the AML compliance regime meets or exceeds regulatory scrutiny. Many companies within this space have taken the approach of providing vast number of searchable fields, drop down lists, and various other techniques to narrow down searches. he reality is that these search fields can be narrowed down to 4 basic types of information. Specifically, Name (individual or corporation), Address, Identification (Drivers Licence, Passport, IBAN, etc.), and Date (Date of Birth, Date of Incorporation, Date of Issuance, etc.).

The other aspect of searches it to take into account the “Additional Data” or “Comment” fields that are found in so many of these databases and lists. As such, searches not only must include the 4 fields, but also fields that are not specific to any one of the 4. This is how KYC2020 has approached the searches. By first looking at the first 4 fields, searches are screened for likely hits. From there, the “Additional Data” or “Comment” fields are search for each of the 4 items. In this way, there is no need to narrow the searches, to say, just “Drivers Licence” or “Passport” as they are typically found in these non-descript fields. The data is typically unique enough that if there is a match, it will be found.

Summary of Case Studies:

KYC2020 is very much a customer focused company. Initially, there was a simple requirement by the first client to be able to search the lists designated by their regulator. This proved the concept and allowed KYC2020 to expand the offerings. The following 3 cases illustrate the challenge and solutions for the small and medium size businesses who were looking for a cost effective solutions that embodied the most comprehensive single source for AML lists as part of their KYC screening process.

Challenge 1: Pay-As-You-Go

The Client’s current KYC List Screening was the bare minimum at best. In order to comply with FINTRAC regulations, it needed a more robust KYC List Screening tool beyond using OSFI, various country related lists, and Google for onboarding their new clients. It was obvious that at this point that pricing that would satisfy the Clients request as long as regulatory requirements were met.

Solution 1

KYC2020 introduced the Client to its sophisticated Search and Scoring Engine (“SSE) for KYC List Screening free 30 day trail. It provided the Client with 25 free checks/day. This allowed the Client to assess the result sets were within their expectation. With over 440 global data sources, the Client was elated that it provides what FINTRAC regulations required and fit well within their onboarding process. KYC2020 then created for the Client a new option, PAY-AS-YOU-GO. This allowed the Client to purchase up to 200 searches to be used whenever. The price? $1.25 to $2 per search. Since then, the client has already used it up the first 200 and is happy to report business continues to growth while meeting all their KYC List screening requirements under FINTRAC.

Challenge 2: Batch processing

The Client’s current KYC List Screening was the very well advanced as they had defined the entire AML Workflow within their organization, and has successfully been audited by the relative regulators as well as external auditors. It was obvious that at this point that pricing that would satisfy the Clients request as long as regulatory requirements were met.

Solution 2
KYC2020 introduced the Client to its sophisticated Search and Scoring Engine ("SSE) for KYC List Screening free 30 day trail. It provided the Client with 25 free checks/day. This allowed the Client to assess the result sets were within their expectation. With over 440 global data sources, the Client was elated that it provided what they expected and fit well within their AML Workflow. KYC2020 then created for the Client a new option, BATCH. This allowed the Client to submit an unlimited amount of requests a day. The price at their current rate? $0.05 to $0.15 per search. Depending on the day. A considerable savings!

Challenge 3: API interface
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Solution 3
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Benefits of all 3 solutions
Implementing KYC2020 List Screening
• Fits easily into existing manual and IT system driven AML workflows
• Ensures adequate controls are in place to meet regulatory requirements for KYC List Screening
• Reduce the cost of implementing KYC List Screening regulatory requirements

Conclusion and Next Steps:

In this white paper, we covered off how small and medium size businesses no longer have to muddle around with manually checking a limited number of lists, nor do they have to justify the exorbitant costs of a KYC List screening tool. KYC2020 has delivered services that meet, and even exceeds the needs of many of these entities, while delivering the most comprehensive and cost effective single source for AML lists for KYC screening compliance.

At KYC2020, we believe that its time for small and medium size business to join the foray of the larger financial entities when it comes to KYC List screening for their AML regimes.

So where to begin? To get started with using KYC2020, sign up for a free 30 day trial. From here you may try the service for free to see if it meets your needs. If it does not, let us know, and we will work with you and organization to come up with a cost-effective solution that does!

Whatever you do, don't delay. By adding a automate tool to do the KYC List screening, you will be saving you and your organization many man hours and reduce the risk of your regulatory body from imposing fines, or even worse, shutting your business down. Not to mention the fact the de-risking aspect of not having a tool in place to satisfy your Financial Institution.