KYC compliance: the rising challenge for financial institutions

An independent survey discussing the real impact of global changes in Know Your Customer (KYC) regulation on financial institutions.

No one can help you Know Your Customer like Thomson Reuters

The intelligence, technology and human expertise you need to find trusted answers.

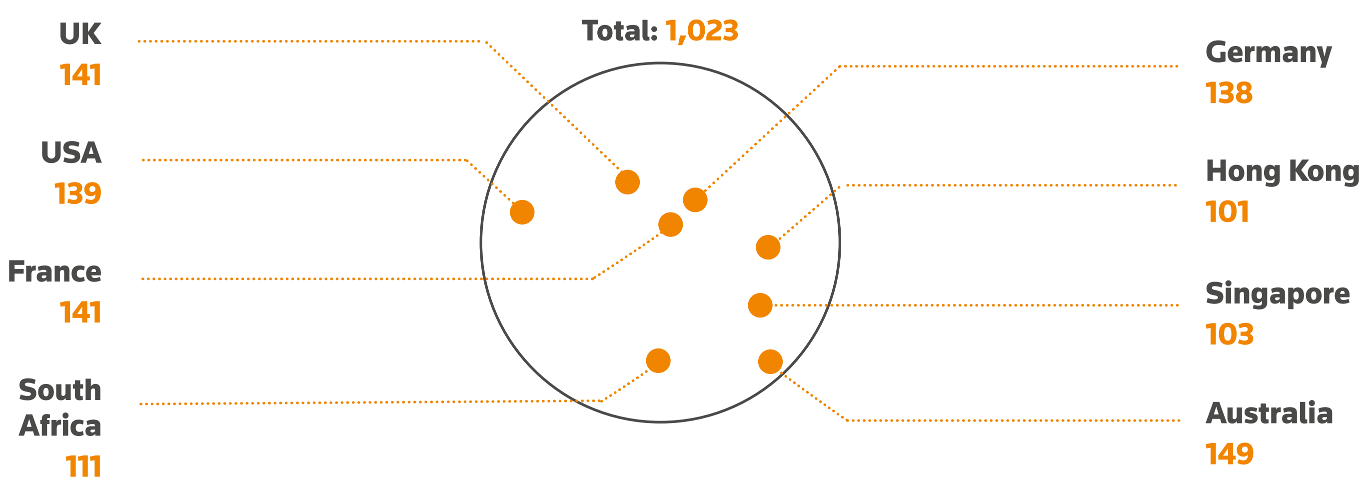
the answer company™
THOMSON REUTERS®

About the survey

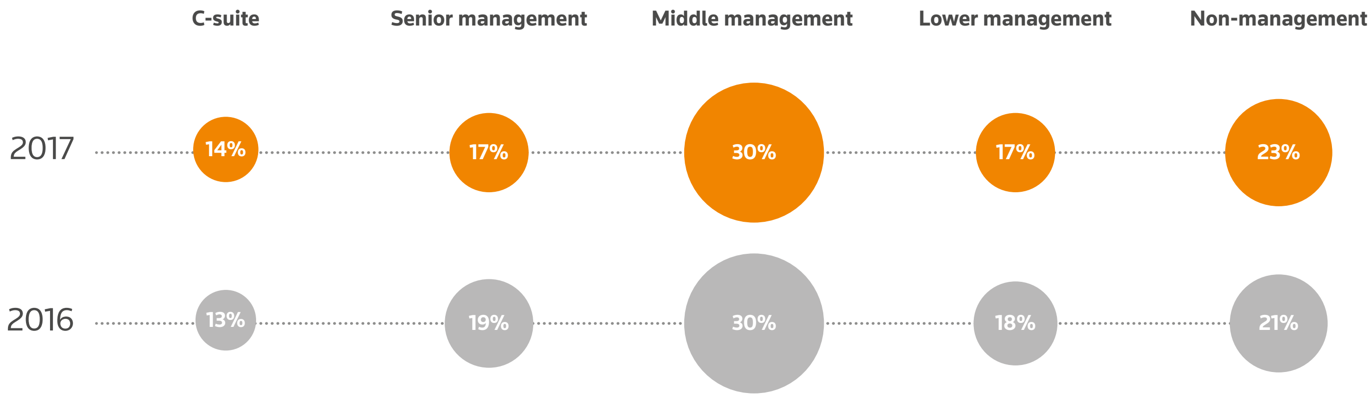
This report is based on research commissioned by Thomson Reuters and was conducted by an independent third party in April and May 2017. A total of 1,023 decision makers from financial institutions (FIs) completed this survey. A separate survey of 1,122 corporate decision makers was also undertaken. All decision makers are involved in KYC-related activities within their organizations, across the UK, France, Germany, South Africa, USA, Australia, Hong Kong and Singapore.

For the purposes of comparison with the Thomson Reuters 2016 survey, carried out by the same independent third party, please note the following differences: the 2016 survey did not include France and surveyed 772 decision makers.

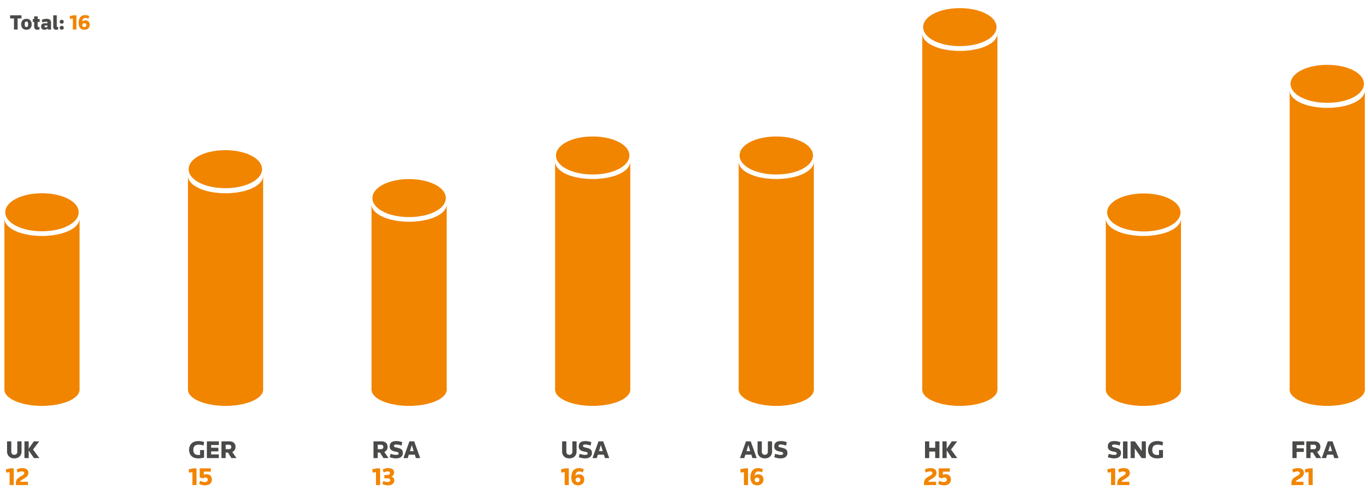
Respondents by region from financial institutions



Seniority



Organization turnover (mean $ billions)



Please note that this report also draws upon the findings of further research carried out by the same independent third party, using the same methodology, but focused instead on corporates' experience of KYC processes.

Our sample survey of FIs was made up of the following organizations: Global Investment Bank (active operations in multiple countries), Global Retail Bank, Regional Investment Bank (operates in a limited area of the country), Regional Retail Bank, Hedge Funds, Asset Management, Insurance and Broker/Dealer.

Please note that the standard convention of rounding has been applied and consequently some totals do not add up to 100%.

Key findings

RESOURCES REMAIN THE BIGGEST CHALLENGE

Despite dramatic increases in headcount and spend, KYC resource still remains the greatest challenge to FIs.

- The largest FIs ($10bn+ turnover) have seen average spend on KYC-related procedures increase from $142m in 2016 to $150m in 2017.
- The number of FI employees working on KYC adherence has rocketed from an average of 68 in 2016 to 307 in 2017.
- Despite the rise in headcount, a third (34%) of FIs report that a lack of resources remains the biggest challenge in conducting KYC and customer due diligence processes.

ONBOARDING TIMES ON THE RISE

Despite continued investment, onboarding times are still rising.

- FIs claim that on average it takes 26 days to onboard a new client, up from 24 days in our 2016 survey. However, corporate customers claim that on average it takes 32 days.
- FIs expect onboarding times to rise again by 12% in 2018. Their corporate customers, however, are more pessimistic, expecting onboarding times to increase by 24% in the next 12 months.
- Banks say they contacted their clients on average four times during the onboarding process, but their corporate customers report that they were contacted on eight occasions.

ONGOING CHECKS NOT FIT FOR PURPOSE

Many FIs have still not implemented all the requirements for ongoing KYC checks.

- 18% of FIs only take action when something occurs to trigger a review.
- Only 8% of FIs believe that their clients are proactive when reporting material changes, down from 14% in 2016.
- Only 30% of corporates made their FIs aware of all material changes.
- The refresh process takes an average of 20 days and three customer contacts.

IMPACT OF REGULATION

A mixed approach to regulatory changes indicates that many FIs lack a clear plan.

- Changes in regulation/legislation (72%) are still the biggest driver for FIs to explore making changes to their KYC processes.
- 23% have not made changes as a result of the FATF Recommendations 2012 and are not planning to do so.
- A third (33%) consider the volume of regulatory change to be a key challenge in the KYC process.

A year on from our last survey, and despite the fact that FIs are continuing to invest significant resources in KYC, the compliance challenge appears to be increasing.

Then and now

When we commissioned our 2016 survey there was a sense that many FIs were still gearing up to address the full and ongoing implications of the FATF Recommendations 2012. A year later, it would not be unreasonable to expect that things would have improved and that processes would now be firmly in place to make KYC compliance more efficient for both the FIs and their customers.

Our 2017 survey reveals the opposite to be true. Client onboarding times have risen, KYC compliance-related headcounts have increased and significant financial and senior management resources are still being directed at the problem. Client experience is suffering, with 12% of corporate clients saying that they had changed banks as a result of KYC issues.

It seems clear that the regulatory environment is putting increasing pressure on FIs as they must focus on both current compliance and prepare for upcoming changes.

This year's survey reveals a change in the dynamics of KYC, with more FIs looking to invest in external resources and third party solutions to help improve the efficiency and regulatory compliance of their CDD/KYC processes.

Expanding requirements

Customer Due Diligence (CDD) is a collective term for the collection of information about, and the verification of, a client's identity and business. CDD requirements for anti-money laundering purposes have been in place in a number of countries since the early to mid-1990s. More recently, in response to major events such as the global financial crisis, the initial requirements have evolved to include a more detailed understanding of risks such as sanctions, politically exposed related parties and ultimate beneficial ownership in the case of legal entities.

These requirements continue to become increasingly intrusive for both regulated firms and their clients, as all FATF member and affiliate countries, move to implement the 2012 revisions to the Financial Action Task Force (FATF) Recommendations.

The FATF 2012 revisions have placed additional requirements on:

- Understanding the identity of customers who are legal persons, including the individuals who own and control legal persons.
- Understanding the money laundering (ML) and terrorist financing (TF) risk posed by customers and their owners and controllers.
- Maintaining knowledge of a customer's identity and the ML/TF risk they pose, as well as the identity and ML/TF risks posed by those who own or control a legal person.

As the FATF undertakes its fourth round of mutual evaluations, against a backdrop of global activity, which is set to continue until 2025, the financial services industry has been working to resolve expanding CDD requirements through extensive in-house remediation, automation initiatives, and most innovatively, through the adoption of shared CDD services.

Our independent survey examines the progress FIs are making to address these increasing CDD/KYC requirements and highlights the challenges they face in doing so.

RESOURCES REMAIN THE BIGGEST CHALLENGE

More staff, money and C-suite time are being dedicated to KYC compliance – but resourcing is still reported as the greatest challenge.

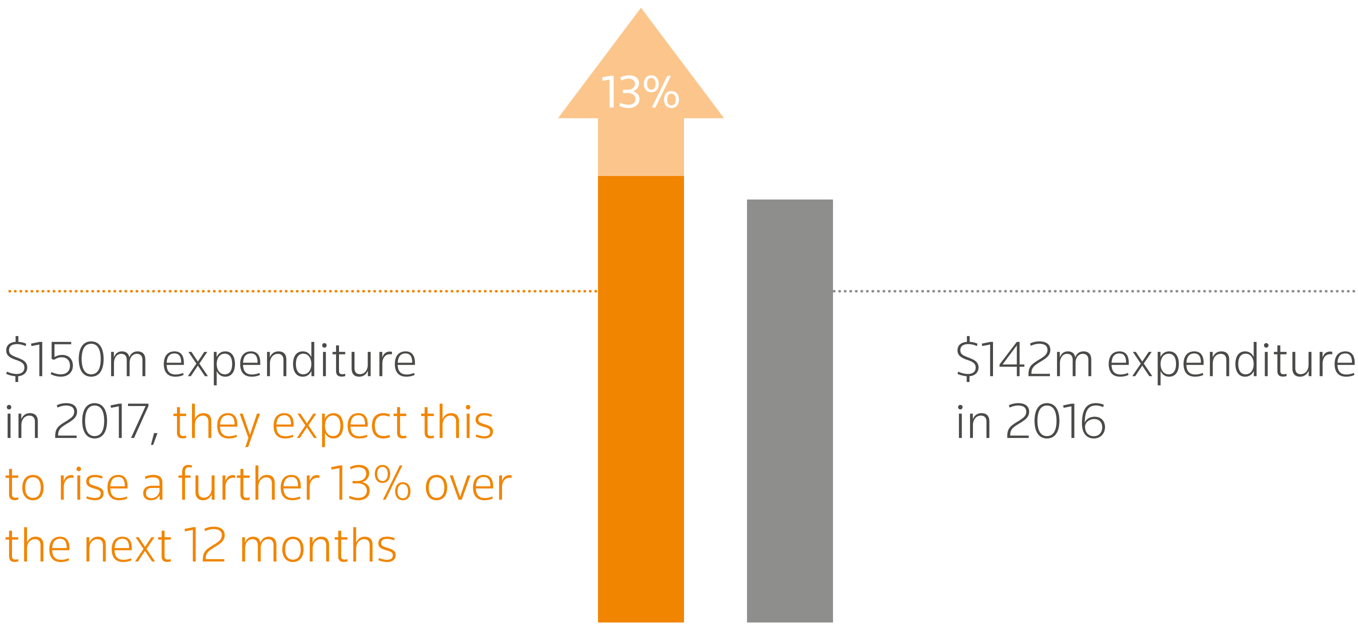
FIs with annual turnover of over $10bn spent $150m in 2017, up from $142m in 2016. They expect CDD/KYC expenditure to rise a further 13% over the next 12 months.

Rising cost of compliance

Large financial institutions have continued to increase their expenditure on CDD/KYC and client onboarding, spending disproportionately more than the average compared to 2016. The costs of compliance manifest themselves in headcount costs from increasing staff numbers and/or compensation, the costs of implementing new processes to ensure compliance with CDD/KYC regulatory requirements and missed revenue opportunities, namely the time and attention that is being diverted from core business activities to managing the CDD/KYC process. FIs with annual turnover of over $10bn spent $150m in 2017, up from $142m in 2016. They expect CDD/KYC expenditure to rise a further 13% over the next 12 months.

Increase in expenditure on CDD/KYC between 2016 and 2017 amongst large FIs with annual turnover of over $10bn

Q. What would be the approximate annual amount that you spend on CDD/KYC globally (including labour and third party costs)?



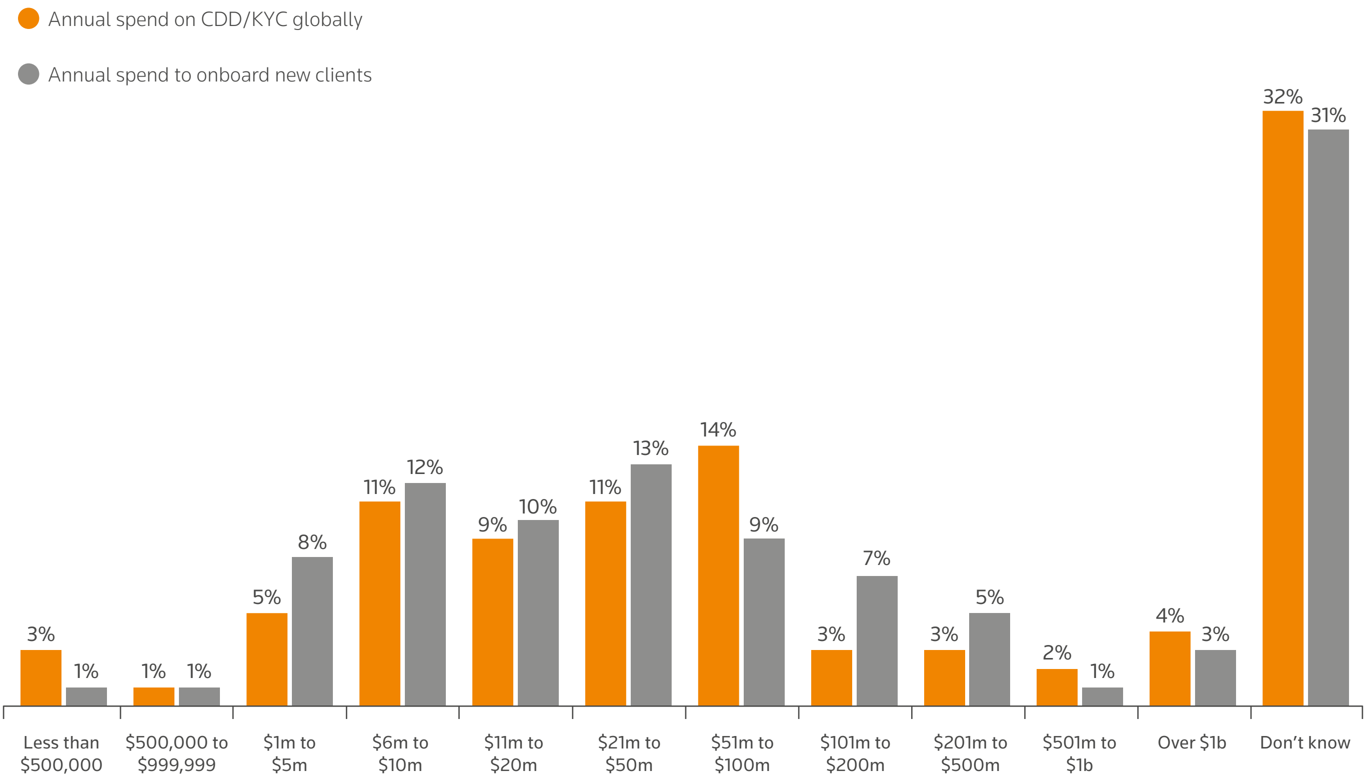
While large FIs have continued to increase their KYC spend, on average the amount spent on KYC by FIs has fallen from $60m to $48m since 2016. This drop is not set to continue, given that respondents expect onboarding costs to increase by 11% over the next 12 months.

The average spend to onboard new clients was $40m in 2017, but this rose to $124m for larger FIs with a $10bn+ turnover. Technology has been a major investment focus for FIs, who are spending 26% of their annual global onboard cost on technology systems to ensure regulatory compliance and drive efficiencies in their KYC and onboarding processes. This rose to 32% for FIs with turnover of above $10bn. And these figures are also expected to rise during the next 12 months.

Annual spend on CDD/KYC and onboarding for organizations with turnover of $10bn+ (mean: $ millions)

Q. What would be the approximate annual amount you spend on CDD/KYC globally (including labour and third party costs)?

Q. What would be the approximate annual amount you spend to onboard new clients globally (including labour and third party costs)?



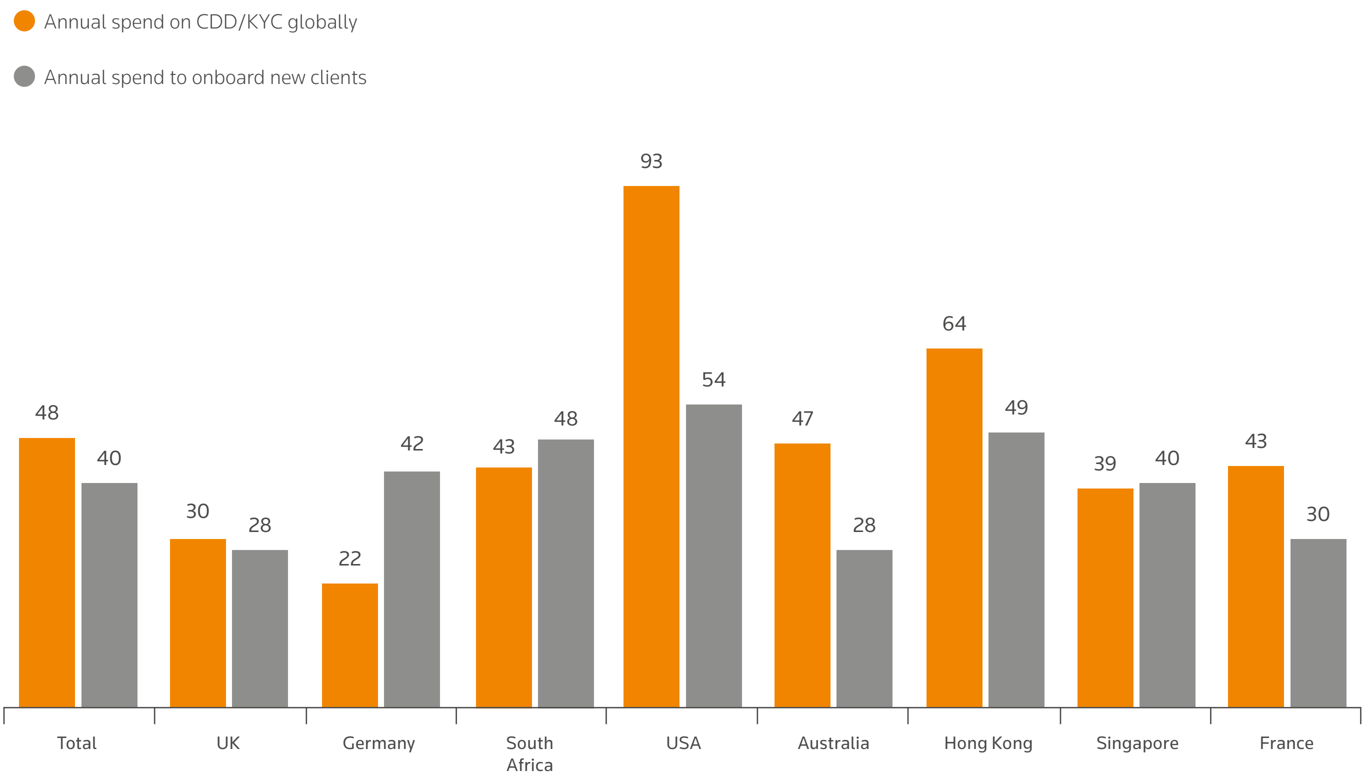
Germany was the thriftiest, spending an average $22m on CDD/KYC, closely followed by the UK at $30m. The US was the biggest spender at $93 million.

Looking only at the money spent on client onboarding, the US tops the spending chart with an average of $54 million in 2017, followed closely by Hong Kong at $49 million. The UK and Australia spent the least on client onboarding at an average of $28m, closely followed by France at $30m.

Annual spend on CDD/KYC and onboarding (mean: $ millions by country)

Q. What would be the approximate annual amount you spend on CDD/KYC globally (including labour and third party costs)?

Q. What would be the approximate annual amount you spend to onboard new clients globally (including labour and third party costs)?



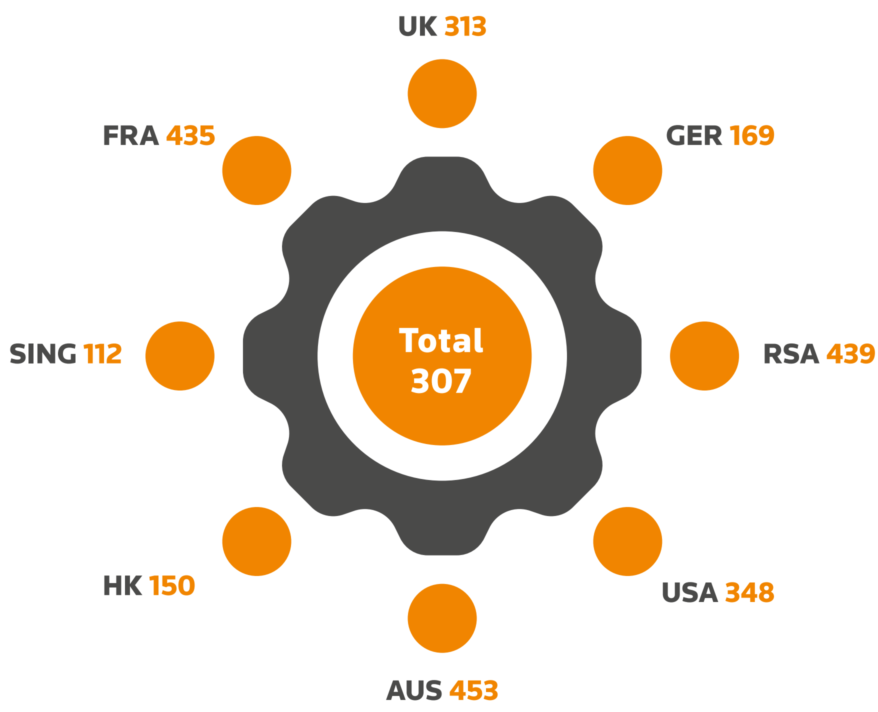
Increased headcount

Over the last year, FIs have attempted to address their KYC challenges by significantly increasing the headcount focused on meeting their CDD/KYC obligations. On average, our survey respondents put the regulatory headcount at 307, more than four times the 2016 figure of 48. For banks, the figure rose nearly fivefold, up from 87 in 2016 to 459 in 2017, and for investment managers it rose from 68 to 221. From a regional perspective, Australia, South Africa, France and the US led the way in terms of the number of dedicated KYC staff.

Despite this dramatic increase in headcount, resourcing KYC and onboarding processes was cited by respondents as the greatest challenge to remaining compliant. This suggests that mass hiring is not an efficient way of managing KYC compliance and financial institutions should explore alternative methods to address their regulatory obligations.

Global workforce on CDD/KYC (mean: no. of employees)

Q. Approximately how many employees do you have globally working specifically on the adherence and processing of CDD/KYC in your organization?



Impact on C-suite

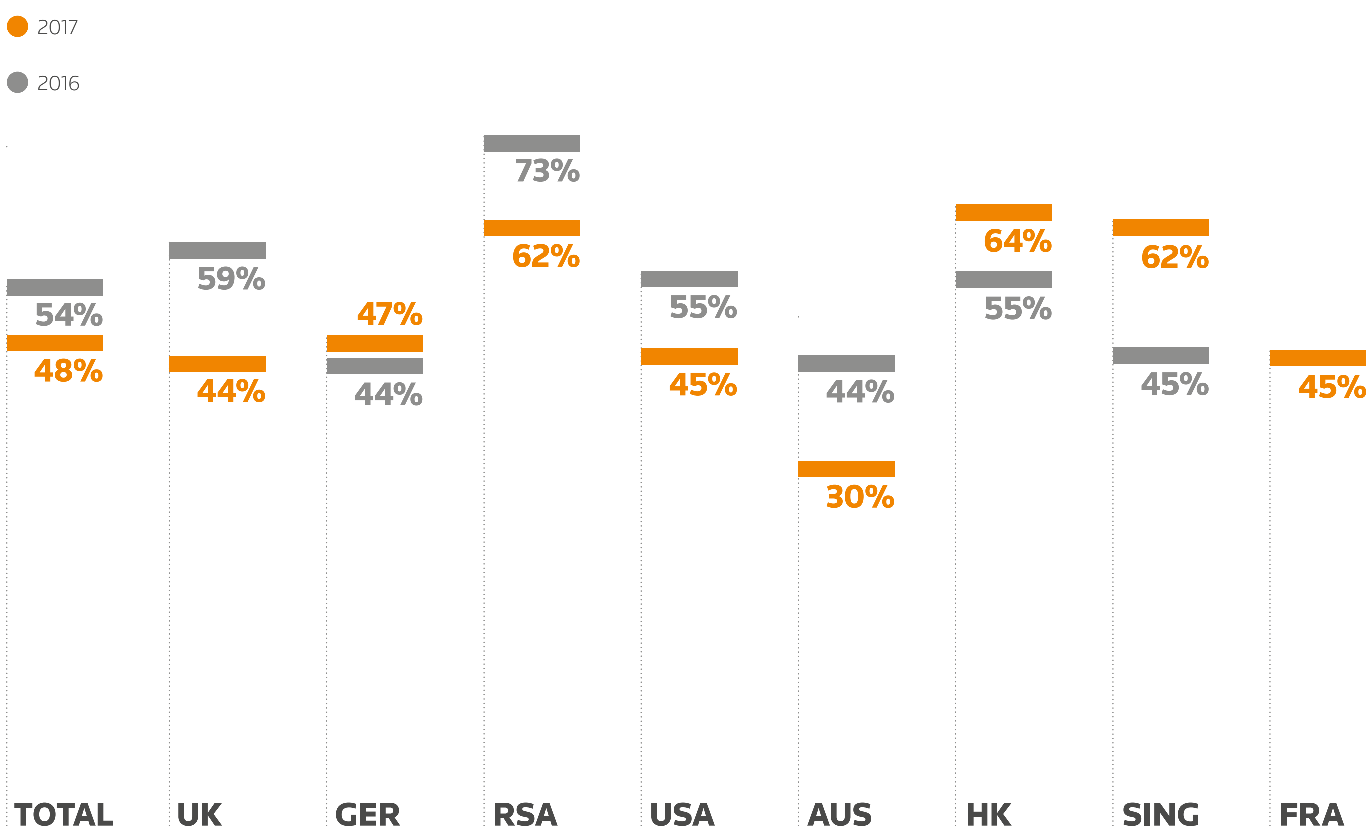
With reputational and regulatory enforcement risks high, boards are seeing KYC compliance as critical for their business.

Our survey shows that valuable senior management time is still being diverted from growth-oriented tasks to focus instead on how their business is going to implement regulatory and infrastructural changes to remain compliant with their CDD/KYC obligations.

60% of C-suite respondents reported that they had dedicated more time and attention to KYC challenges over the past 12 months, while 27% described their involvement as 'significantly more'. On the positive side, this greater senior management awareness of the issue may help to drive change.

Focus of management on CDD/KYC over the past 12 months

Q. How has the amount of time and attention your board of directors and C-suite executives devoted to CDD/KYC changed over the past 12 months?



ONBOARDING TIMES ON THE RISE

Despite increased resources dedicated to the process, averaging onboarding rose from 24 days in 2016 to 26 days in 2017.

The onboarding process is set to take longer, with our respondents expecting onboarding times to increase by a further 12% over the coming 12 months.

Client onboarding results

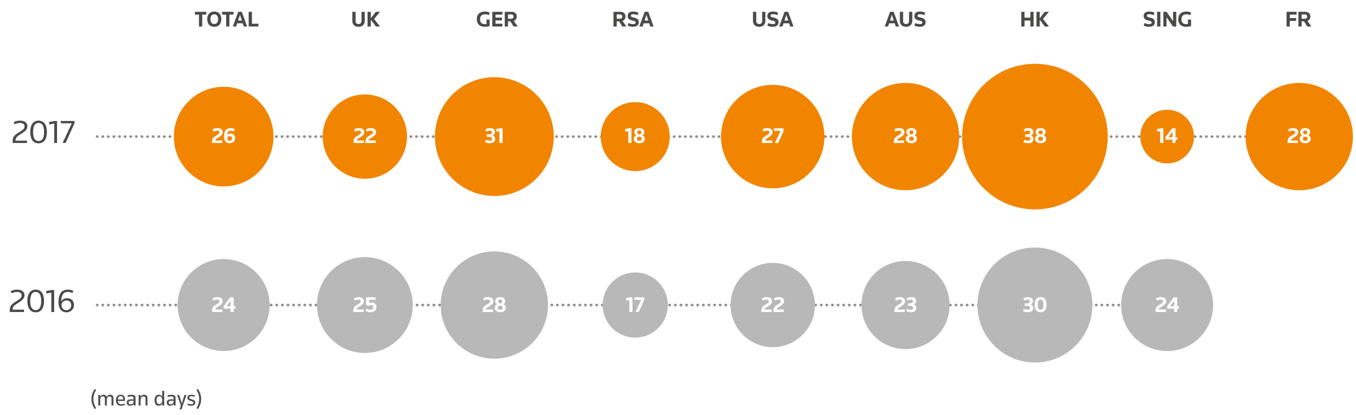
The client onboarding process has two main impacts both of which negatively impact client experience. The first is the time it takes to onboard clients, which pushes back the point at which both clients and FIs can realize the benefits of their relationship. The second is the number of times the client is contacted for documentation, which can be time-consuming and damage the relationship.

These longer onboarding times and multiple touchpoints can be due to local regulatory requirements – for example, the requirement for hard copy documents creates multiple low-value touchpoints between clients and their FI and results in longer lead times for onboarding and refreshing details. They can also be due to FIs' internal processes, with multiple teams conducting different aspects of the onboarding process, leading to duplication and longer onboarding times.

Given this negative impact on client experience, it is a concern that the onboarding process is set to extend yet further, with our respondents expecting onboarding times to increase by a further 12% over the coming 12 months. This means that by the end of 2017, it could take on average over a month to onboard a new client.

Average time to onboard

Q. How long does it usually take to onboard a new client?

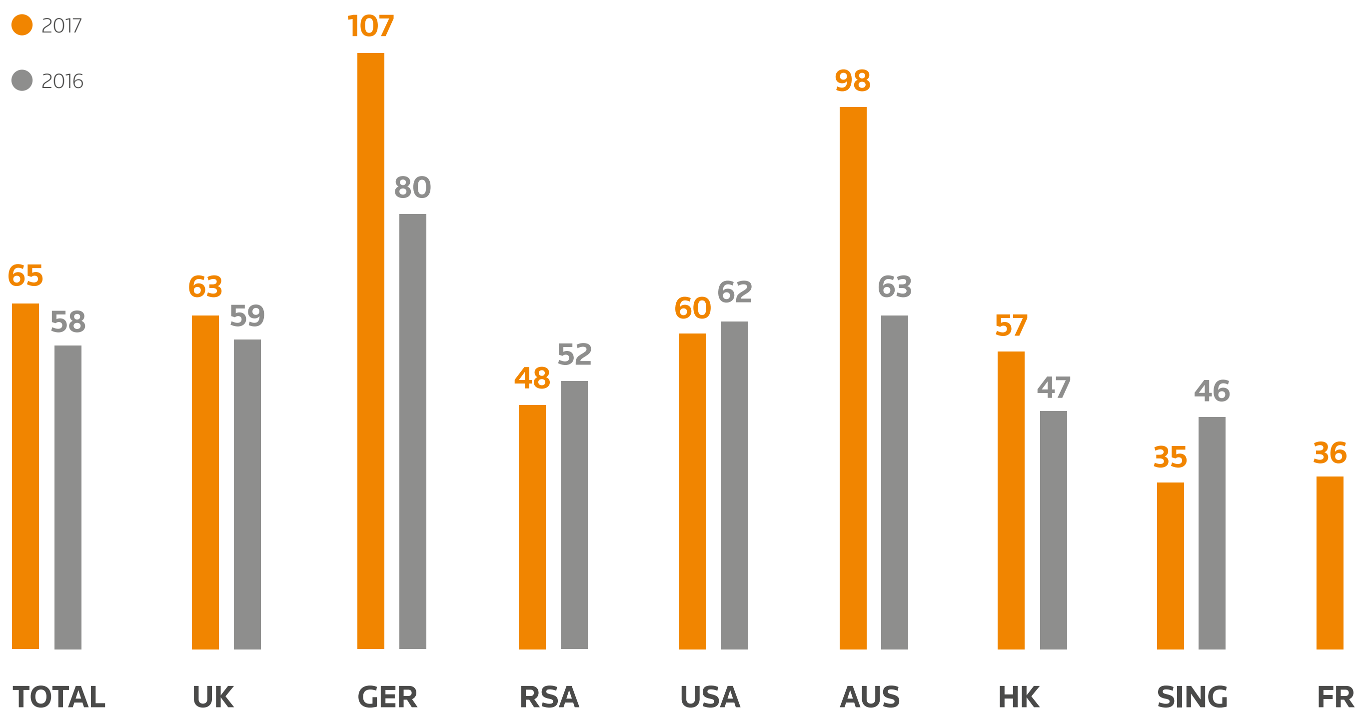


From a regional perspective, Hong Kong has the longest average onboarding process and the sharpest inter-year rise (from 30 days in 2016 to 38 days in 2017), which may be due to hard copy document requirements and the implementation of a 10% threshold for UBO disclosure. Meanwhile Singapore has the fastest process and has also been the most successful at bringing it down, from 24 days in 2016 to 14 days in 2017. While the UK has made some progress in bringing onboarding times down from 25 days in 2016 to 22 days in 2017, the US has gone the other way, rising from 22 days to 27 days.

One positive is that investment managers have been able to buck the trend, bringing onboarding times down from 25 days in 2016 to 23 days in 2017. Banks have gone the other way, however, up from 26 days in 2016 to 30 days in 2017.

Longest time to onboard (mean days)

Q. What is the longest time the process has ever taken for your organization to onboard a new client?



(mean days)

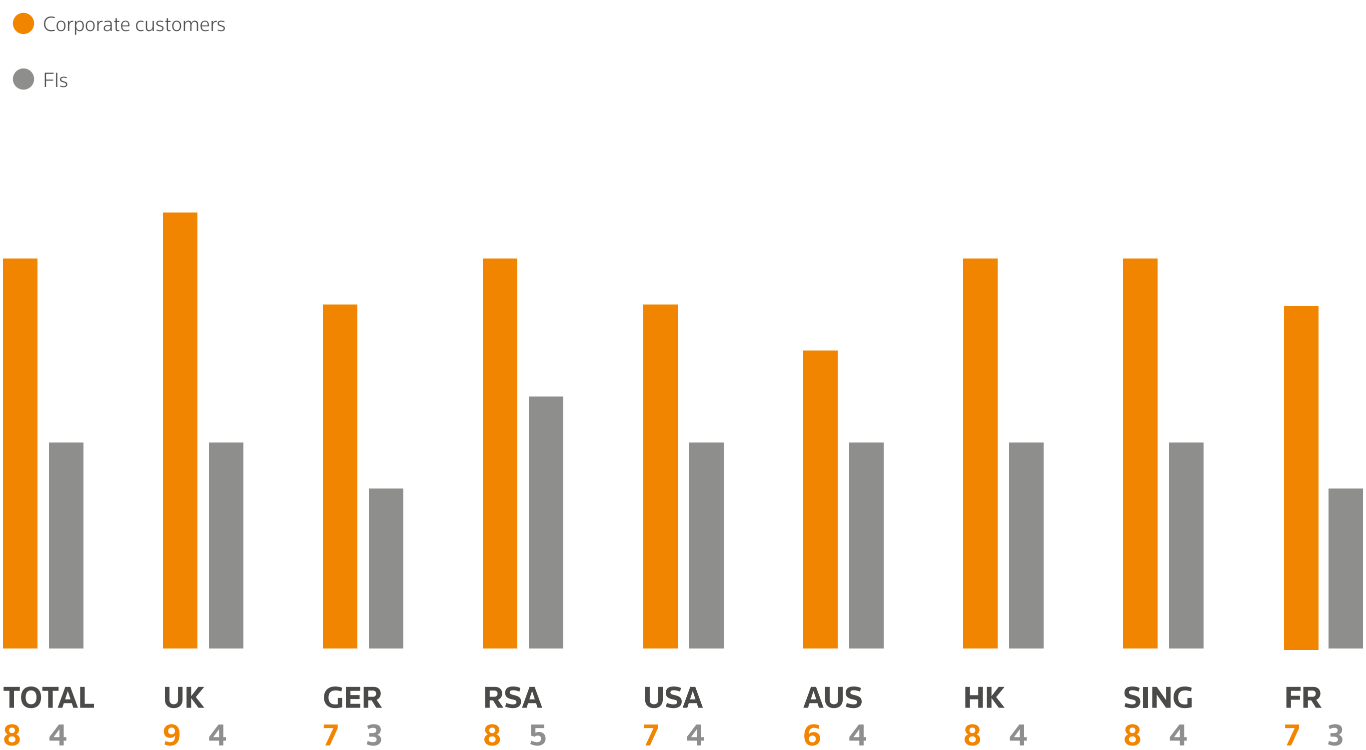
Multiple customer touchpoints complicate the onboarding process

As part of the onboarding process, information and documentation from the client is required in order for the FIs to comply with KYC, FATCA and MiFID II obligations as well as collecting the necessary data to open an account. However, this process often has negative implications on the client experience, as clients are contacted multiple times by the same FI for different or the same pieces of information. The FIs we surveyed said the number of contacts per onboarding was four, which was the same figure as our 2016 survey. Interestingly, this information does not tally with figures from the corporates themselves, who were surveyed separately. Corporate customers report a significantly higher number of average contacts – eight. This suggests that a lack of coordination may be leading FIs to unwittingly duplicate KYC requests and further damage client service standards and relationships. One way this could be reduced would be by minimizing the dependency on clients to provide documentation, instead of collecting as much information as possible from official sources in the public domain.

No. of contacts points during onboarding

Q. Corporate customers: How many times have you been contacted (telephone, email, etc.) during the onboarding process?

Q. FIs: How many times on average is a client contacted during the client onboarding process?



(mean no. of contacts)

ONGOING CHECKS NOT FIT FOR PURPOSE

The need to refresh client information is a regulatory requirement but many FIs are still not up to speed.

KYC due diligence goes well beyond the onboarding stage and continues throughout the client relationship. That means FIs must take steps to refresh the information they hold about their clients to ensure it is up to date and accurate.

Keeping client information up to date

The survey results suggest that there is still a lack of consistency or clear industry standards in the managing, monitoring and refreshing of KYC and onboarding information. A quarter (25%) of FIs said they schedule periodic checks, only 11% use dynamic checks to ensure records are always up to date and 18% only take action when something occurs to trigger a review. This last figure has increased substantially from the 13% in our 2016 report, which is a concern because a more proactive approach is now a regulatory requirement. More worrying still is that a small but a significant 6% have no formal process or program in place, which is only a marginal improvement on last year's survey. This suggests that important changes may not be taken into account, potentially jeopardizing their regulatory compliance.

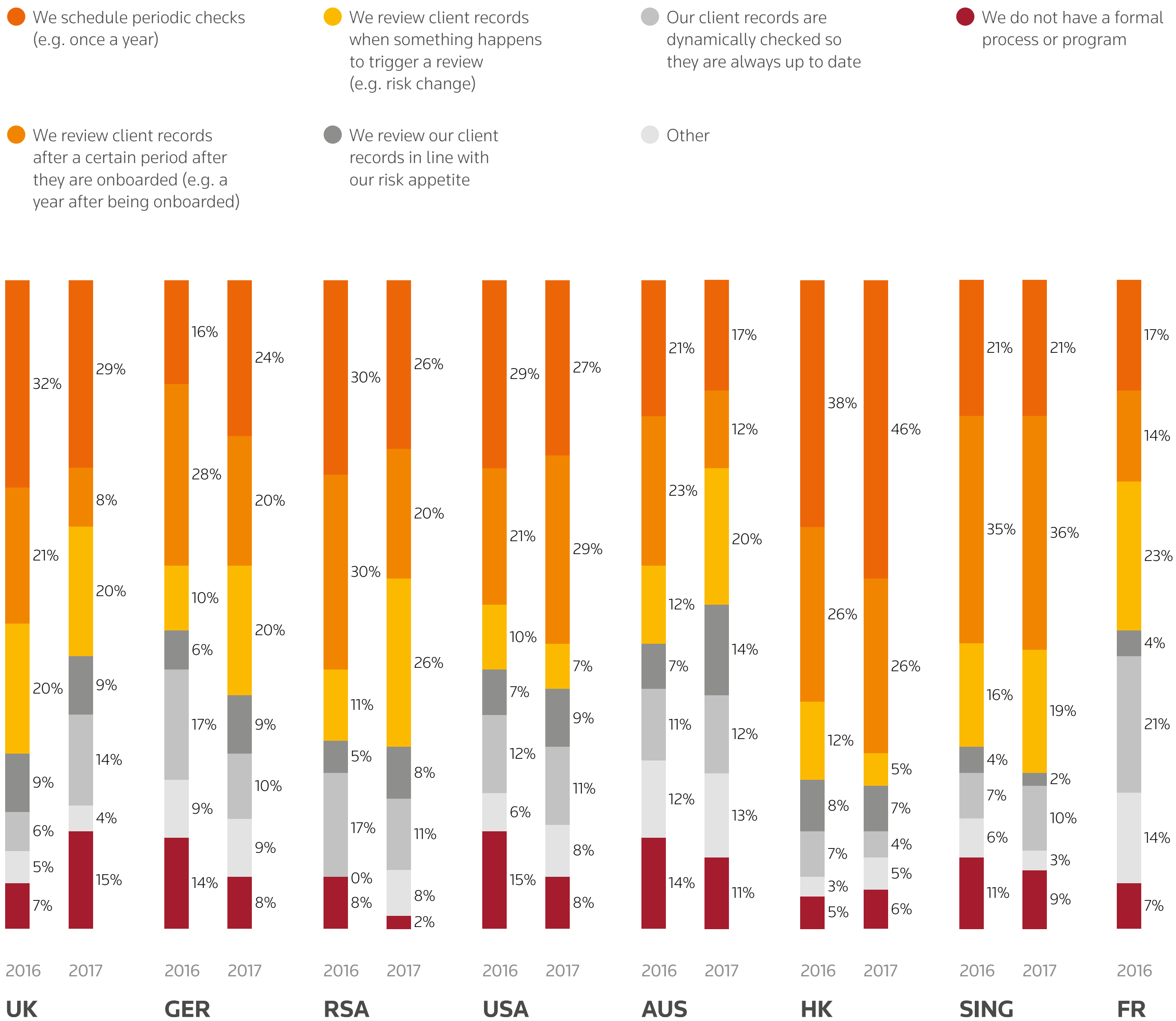
Client responsibility

Only 62% of FIs believe that most or all their clients are proactive in passing on material changes and just 8% of FIs were confident that all of their clients are proactive in updating them about material changes to their companies, which is significantly down from the 14% reported in our 2016 survey.

FIs' caution about the reliability of clients to pass on material changes appears to be justified by our corporate survey results. These reveal that on average corporates have had six material changes over the last 24 months but only 30% had made their FIs aware of all the changes. By failing to implement ongoing checks, FIs are increasing their risk exposure through involvement with clients who may be undertaking new activities or entering new relationships that are not disclosed.

Refreshing due diligence strategy

Q. What is your current strategy for refreshing the due diligence on your existing client records?



Long and complex refresh process impacts client experience

One persistent obstacle for clients may be the length and complexity of the refresh process, which, according to our survey, usually requires three contacts and takes an average of 20 days. Both these figures are consistent with the 2016 survey, suggesting that little progress is being made.

The average longest time taken to refresh has actually increased, from 37 days in 2016 to 42 days in 2017. One impact has been a rise in the cost of refresh due diligence, which is up 12% over the last 12 months and is expected to increase by a further 11% over the next year.

Longest time taken to refresh CDD/KYC (mean days)

Q. What is the longest time the process has ever taken for your organization to refresh the due diligence for a new client?

(mean days)

IMPACT OF REGULATION

A mixed approach to regulatory changes indicates that many FIs lack a clear plan.

On a regional basis, the USA at 50% and South Africa at 49% were the most proactive in terms of having made FATF-driven changes.

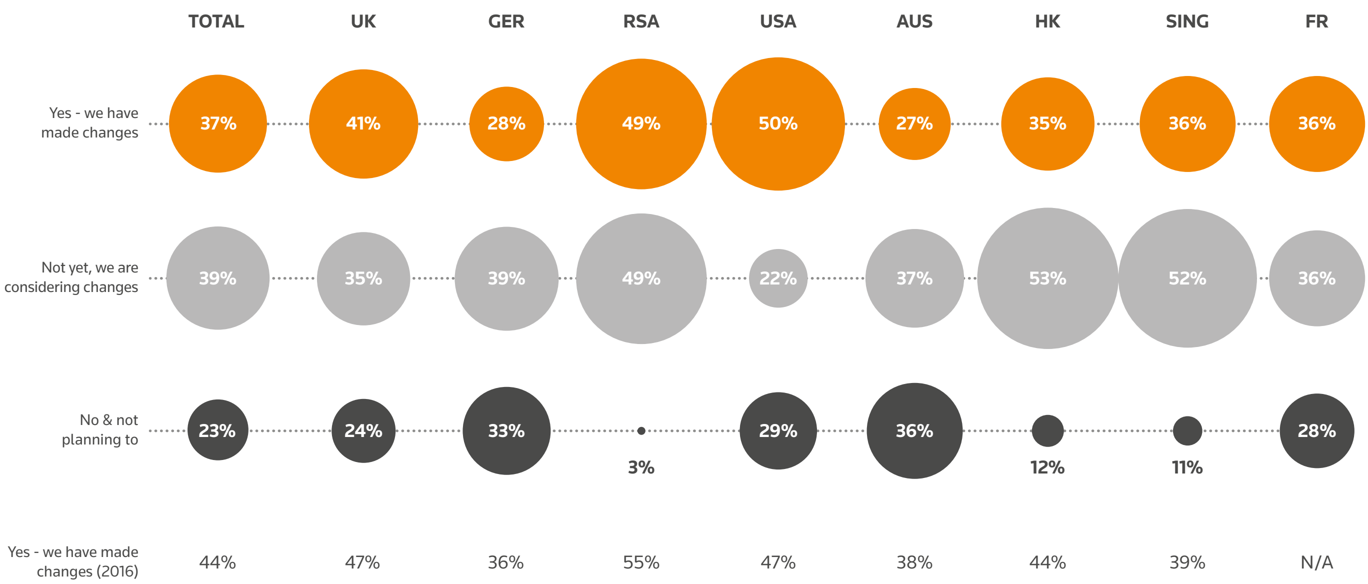
Implementing regulatory change – FATF 2012

Respondents were asked if their organization had proactively made changes to its CDD and/or KYC processes as a result of the FATF Recommendations 2012. In total, 54% of banks and 27% of investment managers said they had made changes, which was below the levels seen in our 2016 survey, when 62% of banks and 44% of investment managers said they had taken action. This fall may be because, 12 months on, FIs have already addressed many of the requirements. There is clearly some way to go, however, with 39% of all FI respondents saying they are now considering making FATF-driven changes.

On a regional basis, the USA at 50% and South Africa at 49% were the most proactive in terms of having made FATF-driven changes, while Australia at 27% and Germany at 28% were the least proactive. Hong Kong, which is due to have its FATF mutual evaluation at the end of 2017/beginning of 2018, was the country most likely to be considering making changes in the future, closely followed by Singapore.

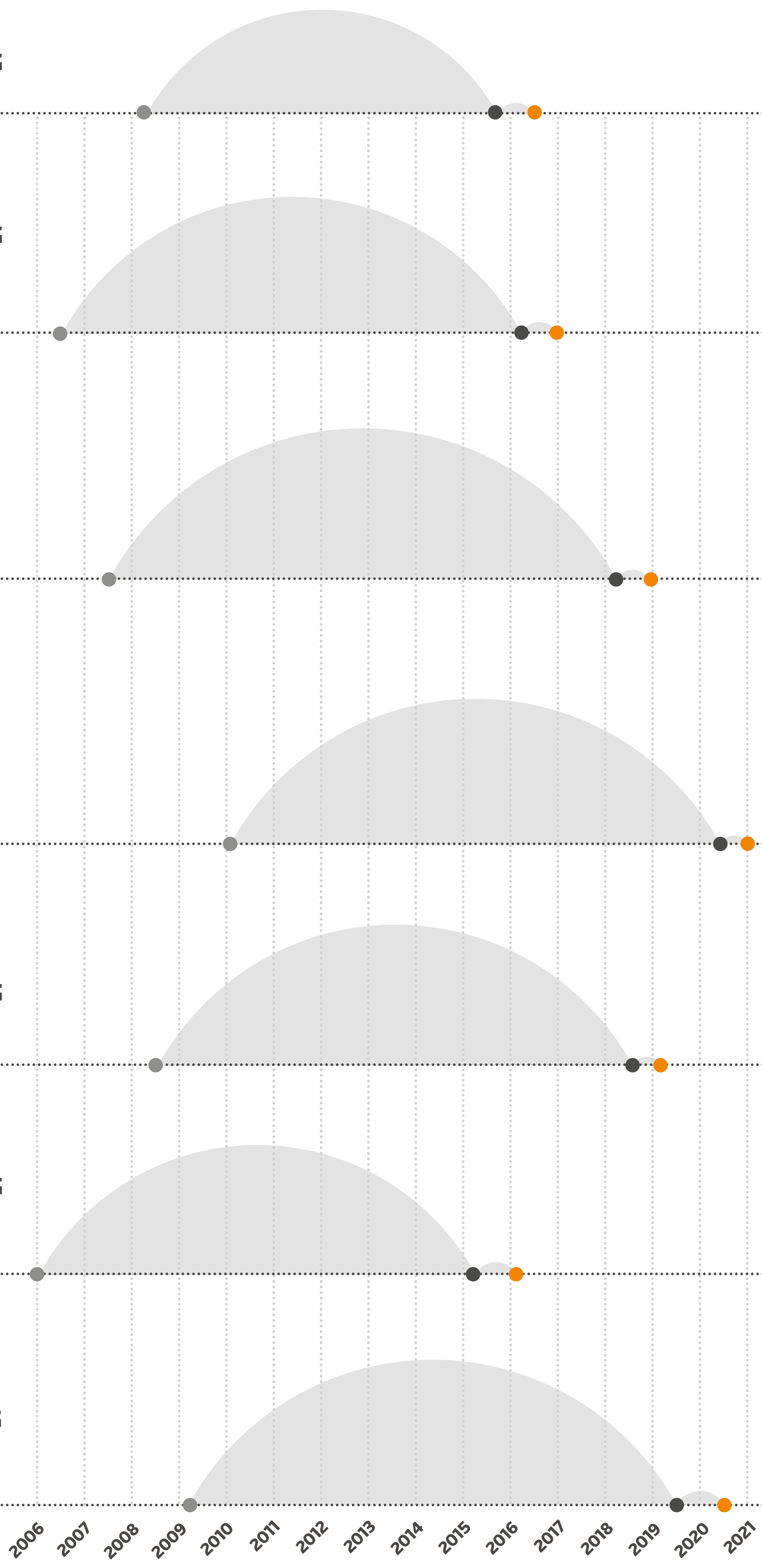
FATF 2012 recommendations on CDD/KYC

Q. Did your organization proactively make changes to its CDD/KYC processes as a result of the FATF Recommendations 2012?



Legislative changes and mutual evaluations

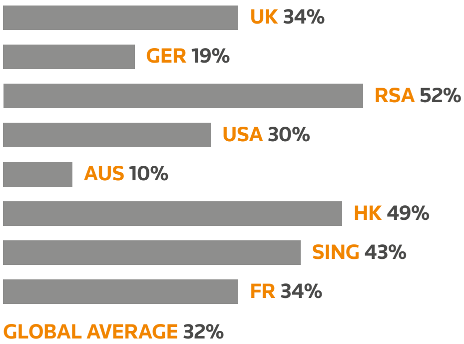
Last FATF mutual evaluation · Possible FATF onsite period · Possible FATF plenary discussion



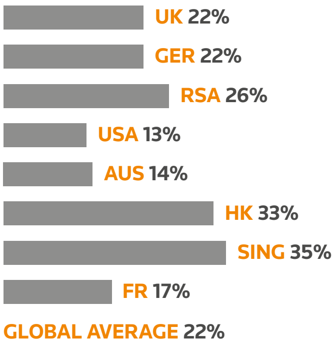
Country and assessment body	Legislation
SING FATF-APG	Monetary Authority of Singapore MAS 626 (revised in April 2015)
USA FATF-APG	Banking Secrecy Act PATRIOT Act Federal Financial Institutions Examination Council - Bank Secrecy Act / Anti-Money Laundering InfoBase Financial Crimes Enforcement Network (FinCEN)
UK FATF	The Money Laundering Regulations 2007 (amended 2012) DIRECTIVE (EU) 2015/849 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (the 4th Directive that countries are required to implement by December 2016)
GER FATF	Money Laundering Act (Geldwäschegesetz – GwG), 2008 last amendment 2013 DIRECTIVE (EU) 2015/849 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (the 4th Directive that countries are required to implement by December 2016)
HK FATF-APG	Hong Kong Monetary Authority (HKMA) and Securities Futures Commission (SFC) Guidelines on Anti-Money Laundering and Counter-Terrorist Financing (revised March 2015)
AUS FATF-APG	Anti-Money Laundering and Counter-Terrorism Financing Act 2006 Anti-Money laundering and Counter-Terrorism Financing Rules - Instrument 2007 (No.1) and amendments (revised CDD Rules June 2014)
RSA FATF-ESAAMLG	Financial Intelligence Financial Act 2012

Q. How are you executing the changes to your CDD/KYC processes as a result of rule changes in your jurisdiction prompted by the FATF recommendations 2012?

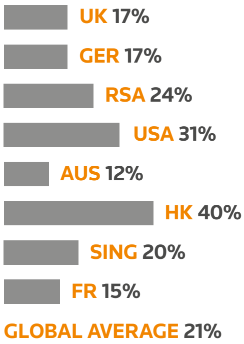
Investing in a combination of internal and external/outsourcing resource



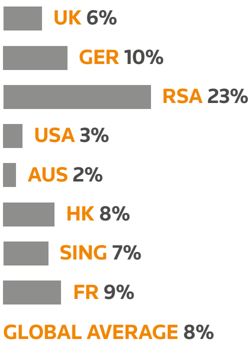
Investing in an existing external outsourcing resource



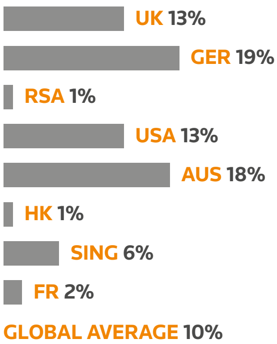
Investing in our internal processes



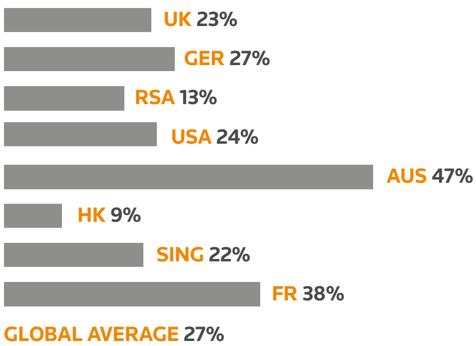
Investing, but don't know how we are going to approach this yet



No, we are not investing



Don't know



Taking action

The approach to implementing FATF-driven changes varies by region, but the most popular choice overall was through investing in a combination of internal and external outsourcing resources. This method was chosen by 37% of investment managers and 51% of banks, but it was particularly popular in South Africa (52%) and Hong Kong (49%), and least popular in Germany (19%) and Australia (10%). In second place was 'investing in external outsourcing resources', which was a notable change from our 2016 survey, which had placed 'investing in internal systems' as the second most likely approach to actioning FATF-driven changes.

This suggests that FIs have begun to acknowledge that their own internal systems are not as effective at enhancing regulatory compliance as they would like. It may also reflect the fact that there are an increasing number of vendor solutions to support FIs. From a regional perspective, Hong Kong was the highest investor in external outsourcing resources, while Singapore was the most likely to favor investment in internal systems.

Key drivers for change

Changes to regulation or legislation were the most likely driver for FIs to alter their CDD/KYC process, with 78% of banks and 70% of investment managers identifying it as a factor. These percentages were considerably below 2016 levels (87% for banks and 75% for investment managers), perhaps reflecting the fact that the pace of CDD/KYC regulatory change has slowed. Regional variations, however, show the impact of local regulators as they make changes to align with global standards. Hong Kong is one example of this trend, and stood out as the most likely to see regulatory change as a key driver (86%), while Germany, further down the regulatory route, was the least (61%).

Fear of financial penalties was the next most likely factor to influence changes to FIs' CDD/KYC processes and South Africa was the standout, with 90% of respondents connected with the region selecting fear of financial penalties. Singapore came next with 80%. Overall, three quarters of banks and two-thirds of investment managers rated financial penalties a key influencer, lower than last year's percentages but still clearly a major driver, perhaps reflecting the regulators' willingness to deliver large fines, particularly in anti-money laundering-related misdemeanors. German FIs were the least concerned, with just 46% of respondents choosing the prospect of financial penalties as a key driver.

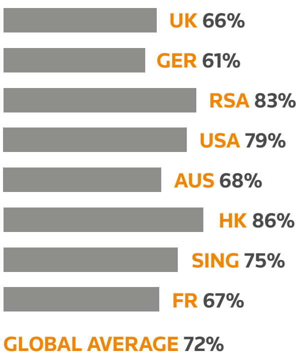
Challenges to the CDD/KYC process

The complexity, size and volume of regulation were again all identified as among the top challenges in the CDD/KYC process, but understanding appears to be growing. In 2017, 16% of banks and 17% of investment managers cited a lack of knowledge of evolving regulation as a key CDD/KYC challenge, which was down from 26% and 17% respectively in 2016.

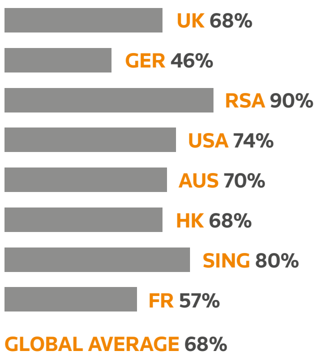
Other key drivers chosen by respondents were damage to reputation, loss of revenue and restrictions to business activity. Although poor client experience came towards the bottom of the list, it was promising that it still registered a relatively high level of attention, with 70% of banks and 63% of investment managers choosing it as a factor in driving changes to CDD/KYC processes.

Q. How influential would the following issues be to explore making changes to your organization's CDD/KYC process?

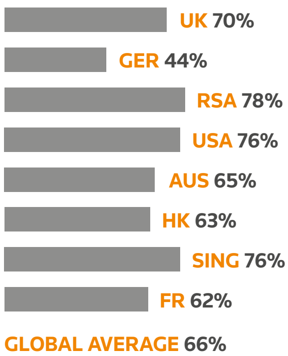
Change in regulation/legislation



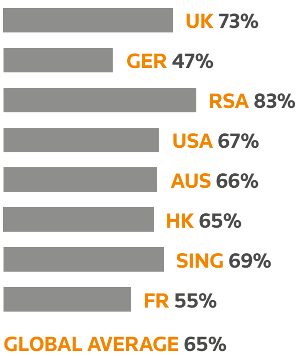
Financial penalties



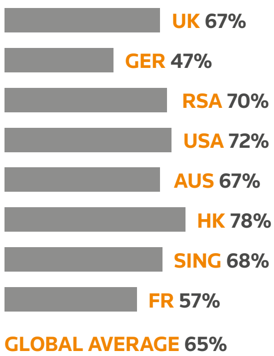
Damaged reputation



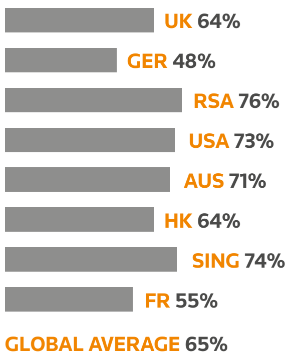
Loss of revenue through inability to onboard/ length of onboarding process

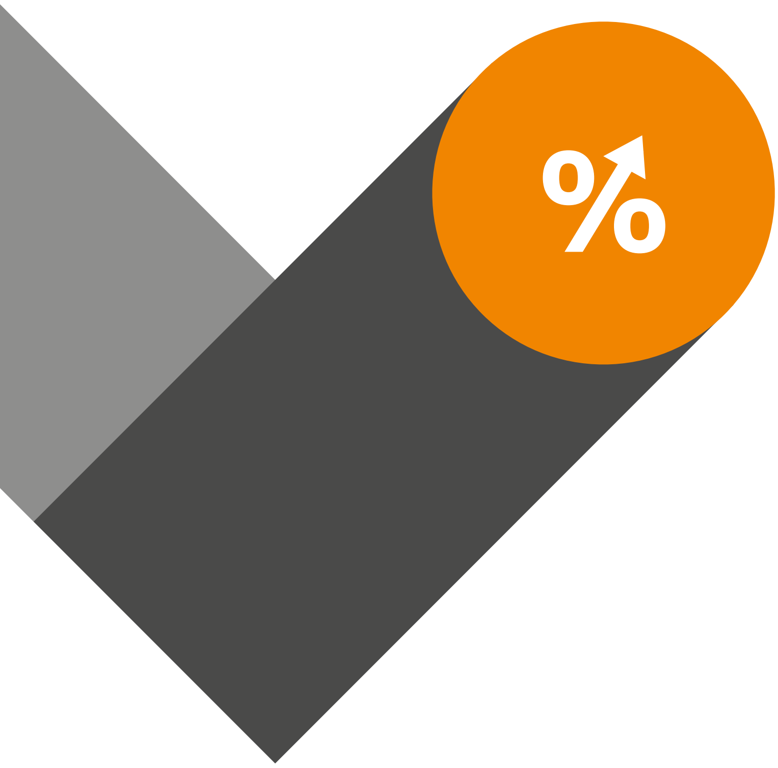


Restrictions on business activity or operations



Poor client experience





TAKING A NEW ROUTE TO REGULATORY COMPLIANCE

As existing methods fail to deliver significant improvement, it is time for a new approach.

CONCLUSION

Despite more time, money and senior management attention being directed towards CDD/KYC compliance, our survey shows onboarding times are rising and ongoing monitoring is falling short of requirements. This not only means that client service suffers and potential revenues are being lost because of delays to onboarding new clients, but that FIs are being exposed to greater risks as ongoing checks on client records are missed.

To avoid these risks to their business, and with existing compliance strategies clearly not delivering the desired result, FIs must look for alternative approaches. While there are opportunities for global regulators to clarify requirements and address some of the more complex challenges that exist, successful FIs will not wait for this to happen and instead take the initiative and innovate.

There is evidence from our survey that this is already happening. Large FIs ($10bn+ turnover) have sharply increased their expenditure on technology, so that nearly one third (32%) of their annual global onboard spend is now on systems to ensure regulatory compliance. We also found that across all FIs there is an increasing focus on investing in external outsourcing resources. There is clear logic to this as the huge increases in compliance-related headcount revealed by our survey have failed to deliver significant improvement, while at the same time rapid innovation is increasing the quality of digital solutions available. By committing to innovation and adopting the technology already available to streamline KYC processes, FIs can put themselves ahead of the regulatory curve and turn their challenge into an opportunity.

No one can help you Know Your Customer like Thomson Reuters

In a landscape of continuous change and increasingly complex regulation, Thomson Reuters empowers the world's leading banks and investment managers to make informed decisions, with our trusted content at its core. We offer a flexible suite of integrated solutions, which have been further strengthened by our acquisitions of Clarient and Avox. Together, these improve the quality of key data on which critical decisions are made, drive operational efficiencies, enhance regulatory compliance and improve the overall client experience.

We provide a connected suite of services to support FIs and their clients to meet the challenges of increased regulation and reporting obligations.

- Thomson Reuters Verified Entity Data as a Service (formerly Avox)
- Thomson Reuters KYC as a Service (formerly ORG ID & Clarient)
- Thomson Reuters Enhanced Due Diligence
- Thomson Reuters Screening Resolution Service
- Thomson Reuters Client On-Boarding

Our award-winning assets of 350,000 built KYC records, 1.25 million actively managed legal entity profiles and database of 7 million legal entities, ensure Thomson Reuters firmly sets the standard in KYC compliance solutions.