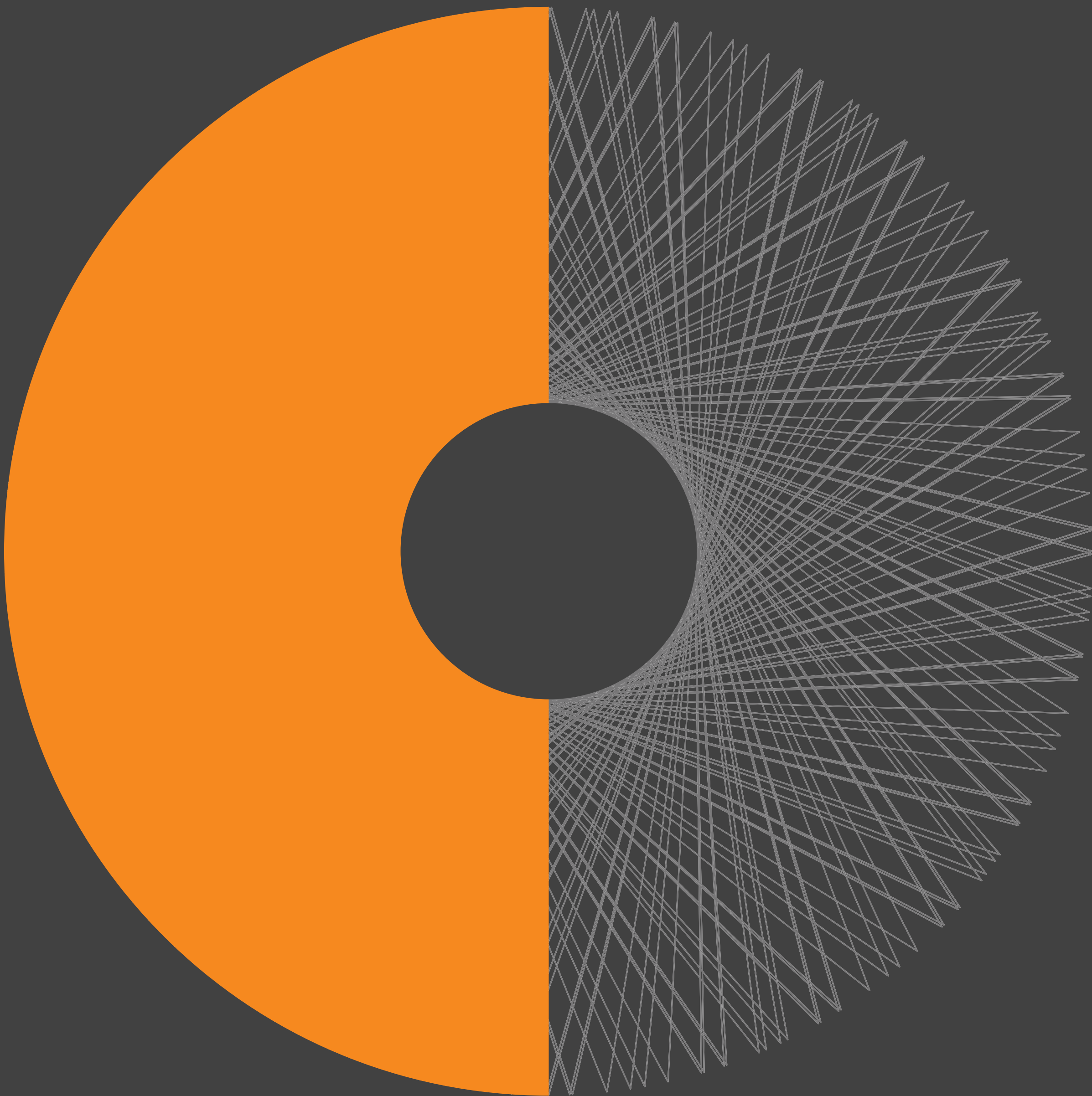
Sound Principle. Complex Reality.

An independent survey discussing the real impact of global changes in Know Your Customer (KYC) regulation on **FINANCIAL INSTITUTIONS**



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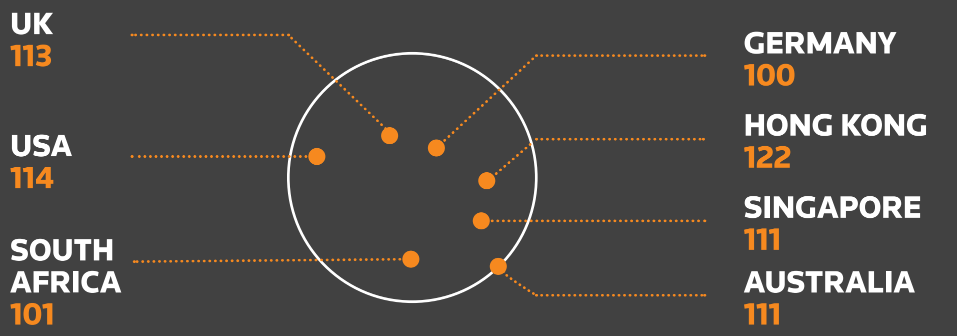
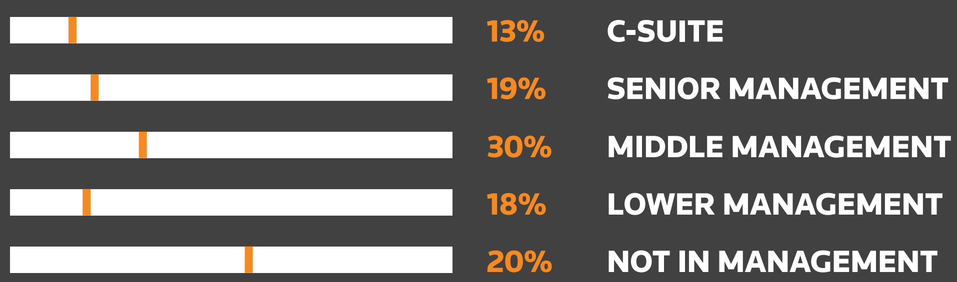
ABOUT THE SURVEY

This report is based on research commissioned by Thomson Reuters and conducted by an independent third party in January and February 2016. A total of 772 decision makers completed this survey from financial institutions (FIs). A separate survey of 822 corporate decision makers was undertaken. All decision makers were involved in KYC-related activities within their organizations, across the UK, Germany, South Africa, USA, Australia, Hong Kong & Singapore.

Respondents by region from financial institutions



Seniority



Organization turnover – mean US $ billions

NB: 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 are 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.

KEY FINDINGS

01. DEDICATED RESOURCES

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Significantly more budget and time are being dedicated to KYC compliance.

- Financial institutions spend on average $60m a year on KYC procedures.
- An average of 68 employees work on KYC adherence and processing within each FI.
- A lack of appropriately skilled people resources is the biggest KYC and client onboarding challenge.

02. CLIENT ONBOARDING

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Lengthy onboarding processes are putting a strain on client relationships.

- An average of 24 days to onboard a new client, 22% higher than in the previous 12 months.
- Banks say they contacted their clients on average four times during the onboarding process, but their corporate customers report eight contacts.

03. CHANGING REGULATION

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In an ever-changing regulatory environment, many financial institutions lack a clear path to implementation.

- One in five FIs has not proactively made changes to their processes as a result of the FATF 2012 Recommendations.
- 87% of banks and 75% of investment managers think that a change in regulation and legislation is the most influential factor when they explore making changes to their KYC processes.

04. ONGOING MONITORING

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Not all FIs have implemented the new requirements for ongoing KYC checks.

- One in ten don't have any formal refresh process in place.
- Only 14% believe that all their clients are proactive about reporting material changes.

HOW WE GOT HERE

The regulatory environment is putting increasing pressure on banks and other financial institutions, as they must both focus on current compliance and prepare for upcoming changes.

Our survey report quantifies and comments on the real world impact of these challenges, but first we will briefly outline the background to the survey and its findings.

A brief history

In the past, KYC procedures only involved routine checks on new clients. The globalization of banking, the events of 9/11 and the financial crisis of 2008 put an end to this relatively relaxed approach. Driving change has been the Financial Action Task Force (FATF), established as a G7 initiative in 1989 to develop policies to combat money laundering. FATF has been the prime mover behind the adoption of a risk-based approach (RBA) designed to move compliance on from a rigid, ‘one size fits all’ methodology to a more pragmatic style. The welcome principle behind this is that FIs can direct their resources more efficiently, so that the greatest risks receive the highest levels of attention.

The less welcome side-effect has been that by leaving room for FIs (and their national regulators) to interpret KYC policies and procedures as they see fit, the picture has become more complex and less coherent. As well as the lack of a common standard for applying existing KYC rules, FIs face the consequences of continuing changes to those rules. The 2012 FATF Recommendations provided FIs with a number of challenges, such as identifying the ultimate beneficial ownership of a customer organization. These Recommendations are increasingly filtering into new regulations across the globe. In addition, there needs to be preparation for the next round of FATF mutual evaluations (which assess a country’s compliance with the FATF Recommendations).

The real impact

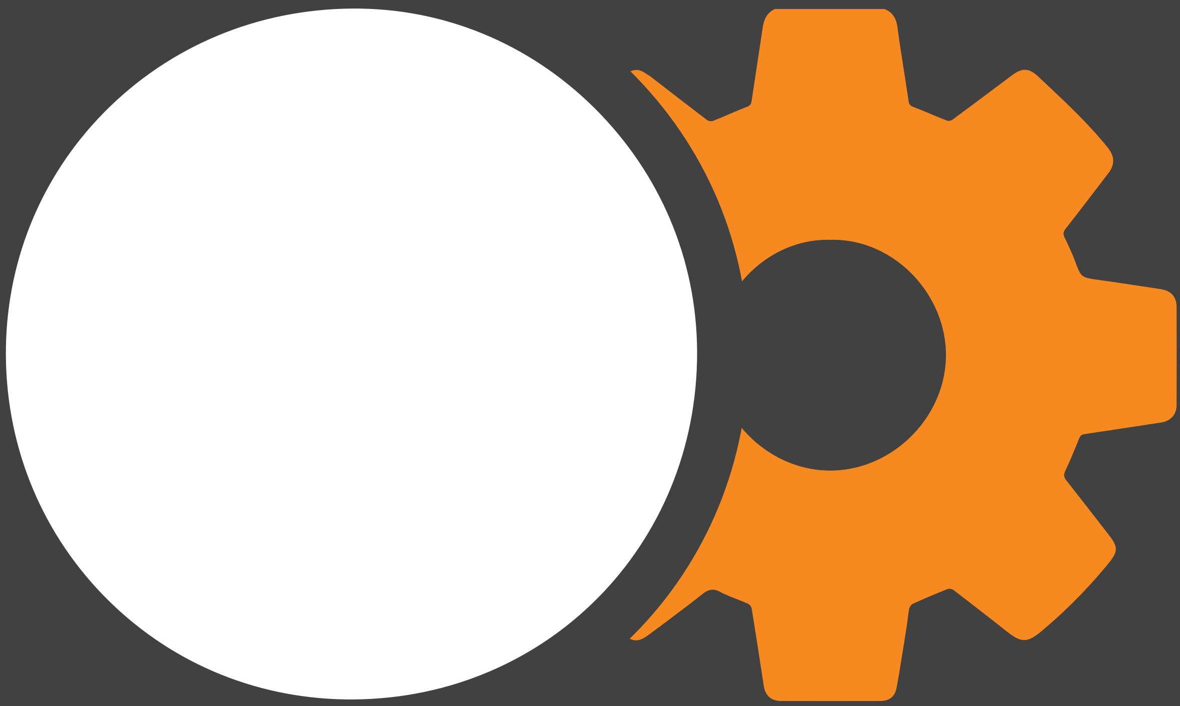
While it is well known that FIs and their customers have found current KYC processes complex and time-consuming, it is important to accurately measure the challenge in order to better address it. Our survey shows the true scale of the problem: to take just one statistic, 13% of corporates said they changed banks because of KYC issues. A sobering thought for financial institutions operating in a highly competitive marketplace.

Things can only get better

In the short term, FIs believe the KYC compliance burden will continue to increase as they deal with the many challenges involved, such as the need for ongoing monitoring of client details. In the medium term, recognition of the problem is driving investment in improving KYC processes and increasing the uptake of third-party industry solutions, such as Thomson Reuters Org ID™ and Client Onboarding solutions.

DEDICATED RESOURCES

More money, staff and senior management time are being dedicated to KYC compliance.



Onboarding costs are expected to rise by 16% over the next 12 months.

Globally, FIs spend an average of $16m on technology systems for client onboarding regulatory compliance.

A significant 70% of C-level respondents reported that they had dedicated more time and attention to KYC changes over the past 12 months.

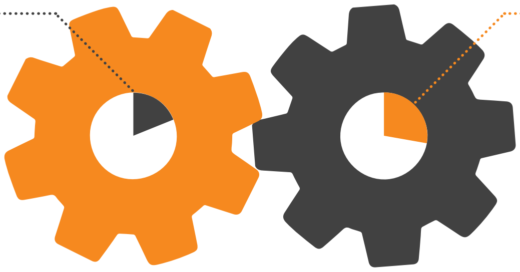
The price of KYC compliance is high and rising significantly.

Costs

Regulatory change is driving longer and more complex KYC processes, and that is pushing costs higher.

Of the FIs surveyed:

19% spend an average of between $1m and $10m a year on KYC



and 21% spend between $11m and $100m

Overall, the average spend by FIs on KYC is $60m, with Germany, Hong Kong, and the UK all allocating $80m or more annually to KYC.

It is interesting to note that, despite recent regulatory changes in Australia and Singapore, their average KYC spend is well below average. In fact, FIs in Australia spend two thirds less than their UK and German counterparties.

In the short term, costs are only going to increase. Onboarding costs alone are expected to rise by 16% for investment managers and 24% for banks over the next 12 months, following a 19% average increase in 2015. Ongoing monitoring costs are also rising sharply as more frequent and structured document refresh processes are put in place.

A significant 28% of annual global onboarding costs are devoted to technology systems for regulatory compliance, with the UK and South Africa the biggest relative spenders at 32%. Australia spends the lowest proportion on technology at 24%. Globally, FIs spend an average of $16m on technology systems for onboarding regulatory compliance, showcasing the importance of implementing the right technology in the compliance space to meet the specific needs of an organization.

Dedicated staff

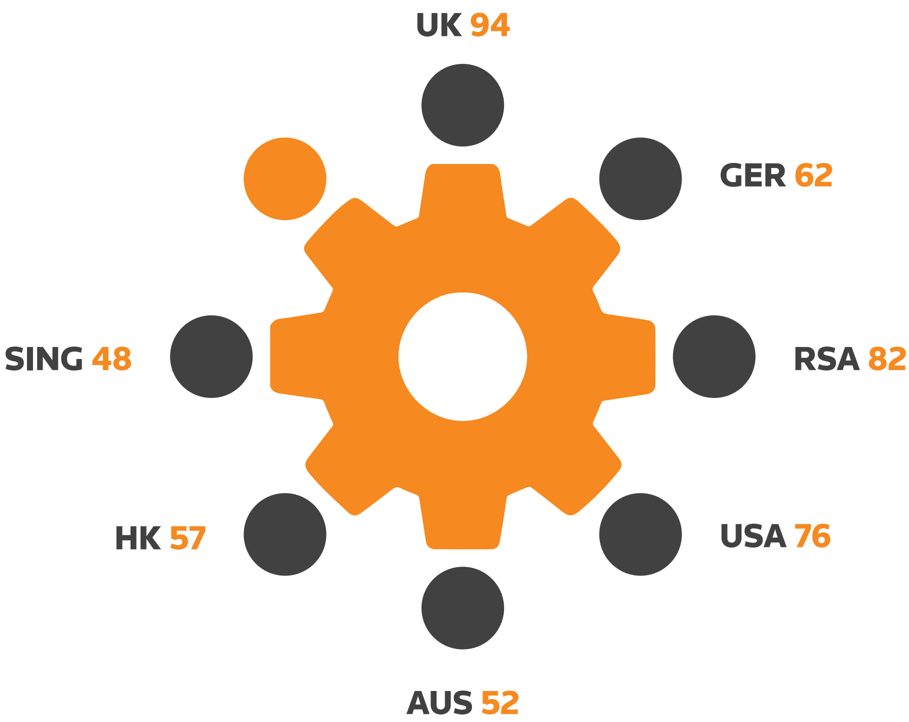
A growing number of employees are required to fulfil KYC compliance.

This is highlighting a shortage of qualified staff and is proving to be an increasing drain on financial institutions' senior management resources.

Increased pressure on staff

The average FI has 68 employees working on KYC adherence and processing, with half of all respondents saying numbers had increased over the last 12 months. Yet, despite this rise, the survey identified that the biggest single challenge in conducting the KYC process was a lack of people resources (36%). The UK stands out as the country with the highest number of staff working on KYC, seeing an average of 94 employees per organization engaged in such activity.

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



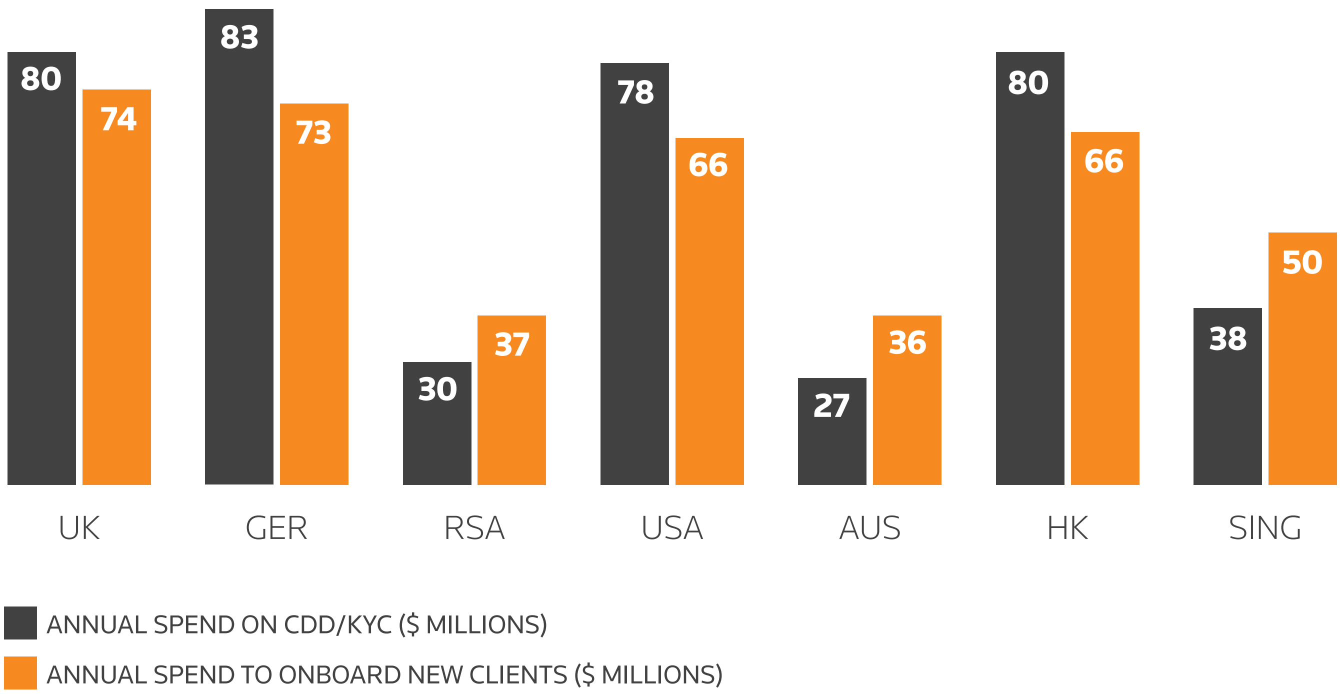
What is the approximate ANNUAL amount you spend on client due dilligence/know your customer globally and to ONBOARD new clients globally? (including labor and 3rd party costs)

On average:

Financial institutions spend $60m on CDD/KYC and $58m on COB each year.

10% of financial institutions spend approx $100m or more on CDD/KYC and client onboarding.

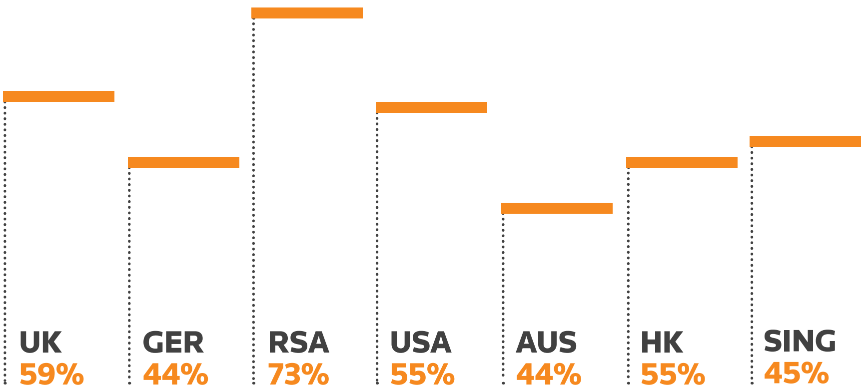
3% of financial institutions are spending over $500m or more on CDD/KYC and client onboarding.



C-level involvement

A significant 70% of C-level respondents reported that they had dedicated more time and attention to KYC and client due diligence changes over the past 12 months, while 19% described their involvement as 'significantly more'. This suggests that valuable senior management time is being diverted from growth-oriented tasks to meet the demands of what are essentially bureaucratic and non-cash generating KYC processes. On the positive side, senior awareness of the issue may help to drive change. Two thirds of respondents at all levels within banks, reported that their senior management and boards had devoted more time to these issues over the past 12 months. Over half of all respondents from investment managers reported the same levels of engagement.

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



% of respondents who reported that their board of directors and C-level executives that have spent more, and have spent significantly more time on and dedicated more attention to CDD/KYC.

INNOVATION TO THE RESCUE?

"Financial institutions have always been leaders in innovation, whether to reduce cost, improve customer experience or expand finite compliance resources. One problem for FIs is that current KYC regulation was originally developed in a pre-digital age, and therefore compliance procedures are not as efficient as they might be if designed today. However, FIs' relentless commitment to innovation means they are addressing the problem by looking to digitize client information and automate processes. This is driving solutions which will see more compliance work automated, whether using internal bank processes or third-party utilities such as Thomson Reuters Org ID and Client Onboarding solutions."

Neil Jeans, Head of Policy and Regulation
Client Onboarding and KYC Solutions, Thomson Reuters

Extracted/adapted from video
https://risk.thomsonreuters.com/Adoption-of-Innovation-in-KYC-and-Client-On-Boarding

CLIENT ONBOARDING

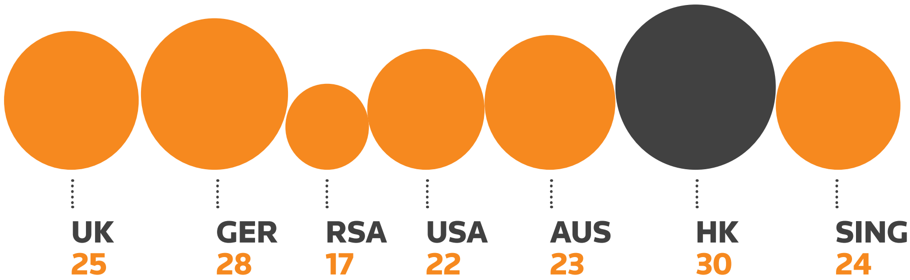
Time-consuming and costly onboarding processes are putting a strain on client relationships.

Average of 24 days to onboard a new client.

Investment managers fared much worse in terms of average longest onboarding periods (at 68 days) compared to that of banks (at 48 days).

Banks reported that 37% use front office staff to complete onboarding processes.

How long does it usually take to onboard a new client? (average mean days)



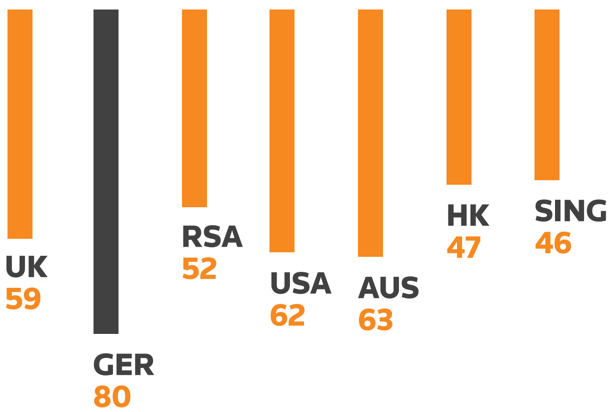
Has client service gone from onboard to overboard?

Taking time

Financial institutions reported that it took on average 24 days to onboard a new client, which is 22% higher than in the previous 12 months. That figure may only get worse before it gets better, with FIs anticipating that time to onboard will increase by 18% over the coming 12 months. This means that by the end of 2016, average onboarding time will rise from 24 days to just over 28 days. In term of individual regions, the US is the most pessimistic, expecting a near 30% increase in onboarding times over the next 12 months.

Regionally, looking at FIs' current average longest onboarding time, this is an astonishing 58 days, with German FIs logging a massive 80 days. Interestingly, within the FI sector, investment managers fared much worse in terms of average longest onboarding periods (at 68 days) compared to that of banks (at 48 days).

What is the longest time the process has ever taken for your organization to onboard a new client? (average mean days)



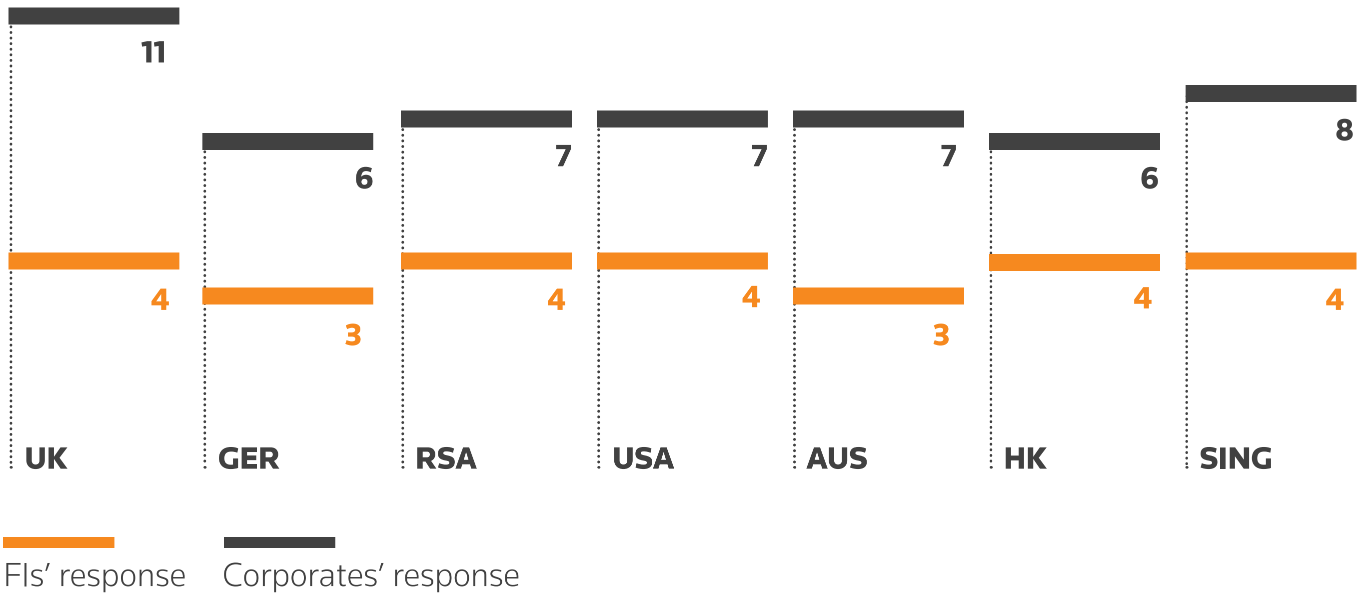
Client service – remember that?

Banks contacted their clients an average of four times during the onboarding process. Contact was made from a number of different bank departments – interestingly, this information does not tally with figures from the corporates themselves, who were surveyed separately. Corporate clients report a significantly higher number of average contacts – eight – across a higher number of different bank departments. This suggests that a lack of co-ordination is possibly leading FIs to unwittingly duplicate KYC requests and further damage client service standards and relationships.

One of the reasons behind this could be that 37% of FIs reported using front office staff to complete KYC requirements with 41% of banks engaging in this practice. Front office staff are often not specifically trained to deal with KYC matters, which may further impact the client experience.

Financial institution survey: How many times on average have you contacted corporations (telephone, email, etc) during the onboarding process in the past 12 months?

Corporate survey: How many times have you been contacted (telephone, email, etc) during the onboarding process in the past 12 months?



Steve Pulley, Global Managing Director, Risk Managed Services, Thomson Reuters

“Given where the world is today, onboarding is becoming a differentiator and those FIs that can get themselves efficiently organized will get there first with new business.”*

IS A SOLUTION ALREADY IN SIGHT?

“If banks could automatically access whatever client information they needed, whenever they needed it, many of their challenges could be greatly reduced.

That’s the driving force behind the creation of KYC managed services: providing a central and secure data repository where confidential client information and documents are held according to strict data and information security requirements. Thomson Reuters Org ID is one such service and can conduct client due diligence on behalf of the financial institutions to a standardized policy. In addition, it can provide ongoing monitoring of KYC records to ensure they are kept up to date.

The result is a managed service to perform KYC due diligence and facilitate the provision of KYC information, helping FIs to simplify and streamline the KYC process – and accelerate the ability to do business.”

*Extract from: https://risk.thomsonreuters.com/video/strong-global-enforcement-culture-set-to-continue-significant-fines-and-other-penalties-expected-2016

REGULATORY CHANGE

Regulation is the real driver behind most of the survey findings already described. What are the key issues?

Only 44% of FIs proactively changed their KYC processes in response to the FATF 2012 Recommendations.

64% of investment managers and 65% of banks respondents identified reputational risk as likely to influence changes in their KYC processes.

34% of FIs consider the volume of regulatory change challenging.

FIs are operating in an ever-changing regulatory environment.

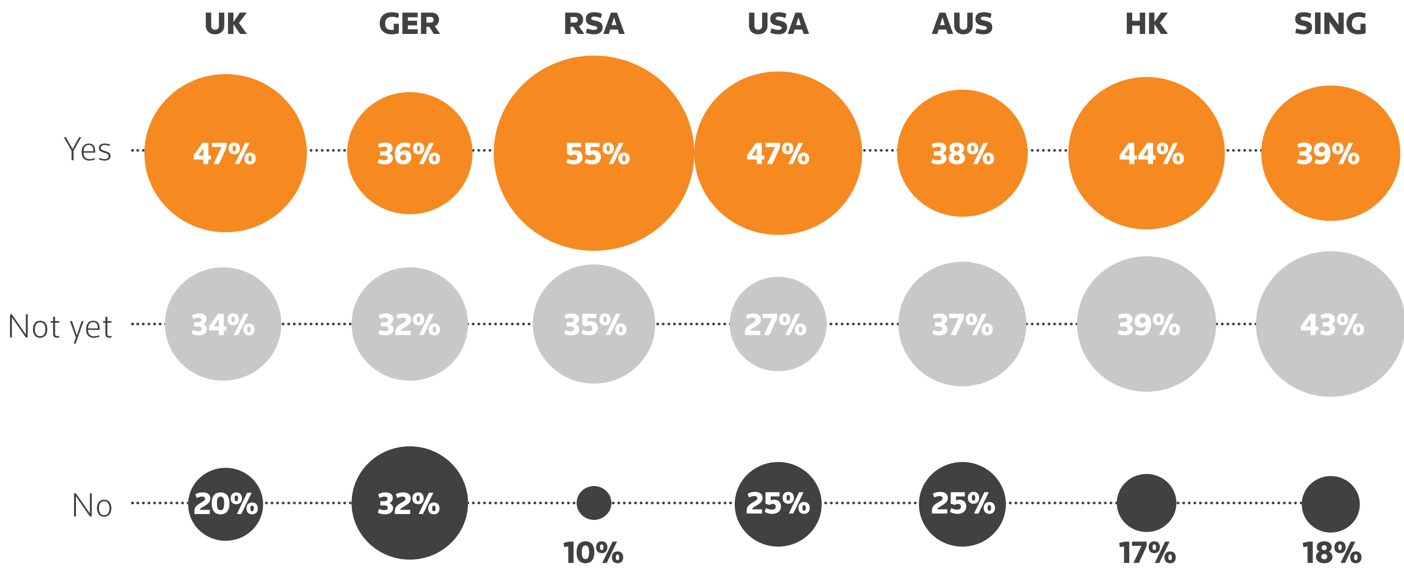
2012 FATF Recommendations

The survey revealed that only 44% of FIs proactively made changes to their KYC process as a result of the 2012 FATF Recommendations, although a further 35% are considering doing so. This leaves one in five FIs that is not planning to make any changes, which suggests some lethargy in implementing regulatory change. This is perhaps surprising given the reputational and financial risks that FIs may become exposed to if they do not if they do not remain fully compliant with regulations. The fact that 64% of respondents identified reputational risk as likely to influence changes in their KYC processes suggests they are aware of the issue, but may not be sufficiently proactive in addressing it.

On a regional level, Germany appears to be the least concerned with the 2012 FATF Recommendations, with an average of 32% of local respondents not planning to make any changes as a result. South Africa is the most concerned, with an average of 55% making changes and a further 35% considering doing so. This may be because of recent regulatory action in South Africa which has resulted in an increased focus.

The most likely change to be made as a consequence of FATF was 'Investment in a combination of internal and external outsourcing resources', which was chosen by 37% of investment managers respondents and 51% banks respondents globally. This option was particularly popular in South Africa (49%) and the UK (40%), while Australia (30%), the USA (31%) and Germany (31%) found it least attractive.

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



Regulation – broader impacts

87% of banks and 75% of investment managers think that regulation/legislation would be most influential in terms of driving changes in their KYC and customer due diligence processes. Drilling down, German FIs rated regulatory change as far less influential (61%), while South Africa scored it highly (89%). The next most important factor likely to influence KYC change was financial penalties.

Nearly seven out of ten of those FIs surveyed are concerned about restrictions on business as a result of KYC failure. Almost as many – 67% – report that loss of revenue through the inability to onboard or the length of the onboarding process would influence changes to their organization's KYC and CDD programs.

Engagement with regulators

More than half of FI respondents reported that the engagement with their organization by regulators has increased, with 17% saying it had "increased significantly." The volume of regulatory change was cited as a challenge by 34% of respondents, while 33% mentioned the size and complexity of the changes required.

How influential would the following issues be when deciding to explore making changes to your organization's KYC/customer due diligence process?

Graph only shows those who were influenced.

Change in regulation/ legislation

UK 82%
GER 61%
RSA 89%
USA 75%
AUS 65%
HK 80%
SING 80%

Global average = 76%

Financial penalties

UK 78%
GER 44%
RSA 82%
USA 76%
AUS 60%
HK 71%
SING 79%

Global average = 70%

Restrictions on business activity or operations

UK 81%
GER 42%
RSA 82%
USA 73%
AUS 56%
HK 71%
SING 71%

Global average = 68%

Damaged reputation

UK 75%
GER 48%
RSA 76%
USA 66%
AUS 59%
HK 54%
SING 67%

Global average = 64%

Loss of investor confidence

UK 70%
GER 49%
RSA 78%
USA 65%
AUS 56%
HK 59%
SING 69%

Global average = 64%

Poor client experience

UK 73%
GER 56%
RSA 77%
USA 69%
AUS 55%
HK 63%
SING 73%

Global average = 67%

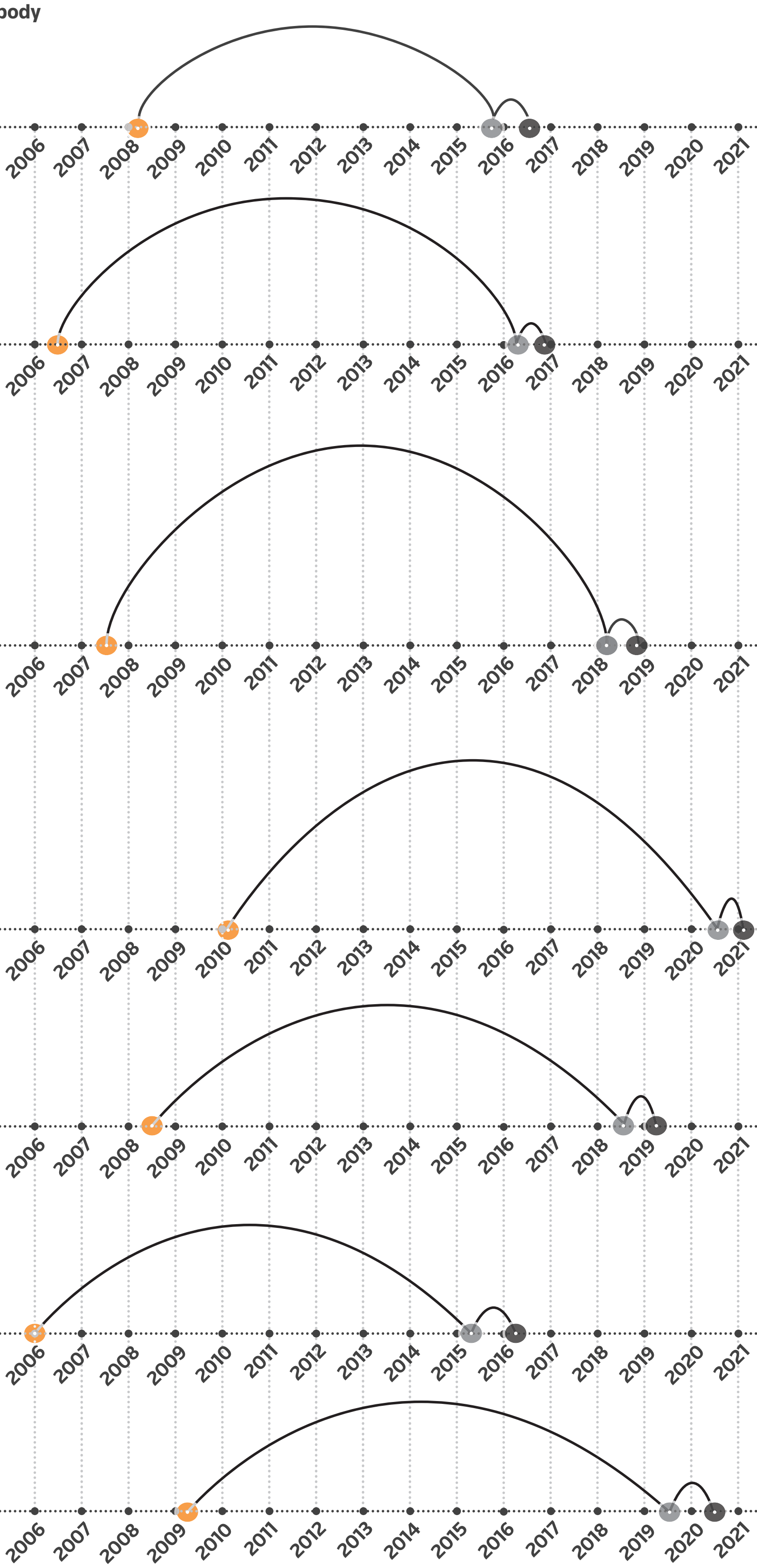
Loss of revenue through inability to onboard/length of onboarding process

UK 72%
GER 53%
RSA 77%
USA 68%
AUS 63%
HK 61%
SING 74%

Global average = 67%

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

Legislative changes and mutual evaluations



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

ONGOING MONITORING

Not all FIs have implemented the new requirements for ongoing KYC checks.

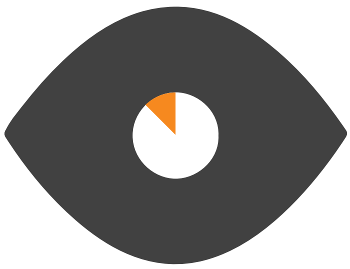
Only two thirds of FIs believe that most or all of their clients are proactive in passing on material changes.

Clients can expect an average of three FI contacts during the due diligence refresh process.

Costs to due diligence have increased 16% in the past 12 months.

Although this is now a key KYC requirement, many FIs are not up to speed.

Changes in regulatory requirements mean that KYC due diligence now goes well beyond the onboarding stage and continues throughout the client relationship. It is important to note here that, for FIs, the application of just one monitoring technique will not meet legal and regulatory expectations going forward.



13% refresh
only after something occurs to trigger a review.

Core processes

A lack of consistency was clear from the survey results, with a variety of approaches taken, including 13% who refresh only after something occurs to trigger a review. This suggests that important changes may not be taken into account, potentially weakening the banks' risk management and compliance processes, as they do not have up-to-date profiles of their clients.

Onus on clients

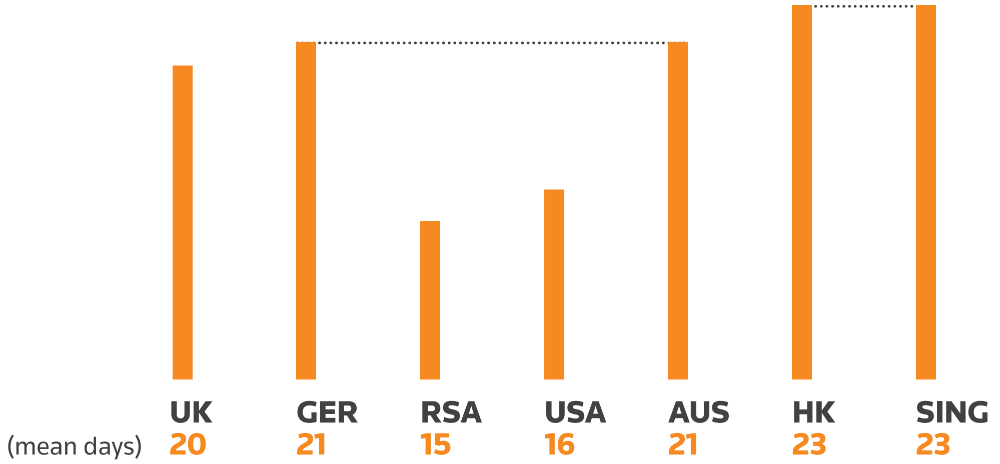
Some FIs may argue that this is mitigated by the fact that the regulatory onus is now on clients to pass on any material changes. However, survey results provide little comfort on this score. Only two thirds of FIs believe that most or all of their clients are proactive in passing on changes, indicating that the ball cannot safely be left in the client's court. In fact, just 14% of FIs claimed that all of their clients are proactive in updating them about material changes to their companies.

The FIs' caution appears to be justified by our corporate survey results. These reveal that three quarters of corporates had at least one material change during the preceding 24 months but 69% had not made their financial institutions aware of all the changes.

Lengthy procedures

Perhaps some explanation for corporate foot-dragging on material changes, and FIs' reluctance to schedule additional checks, is the time a refresh takes – on average 20 days, which is an increase of 16% over the last 12 months. FIs say they contact their clients an average of three times during this process.

How long does it usually take to refresh the due diligence on a client?



Refresh costs

The cost of ongoing changes is also on the up, with survey respondents expecting refresh costs to rise 16% in the next twelve months, on top of the 16% hike they saw in the previous 12 months before the survey was carried out.

KEEPING CURRENT

"The real change and challenge for FIs is around maintaining KYC and keeping it current. Having the right operating processes in place is vital to this.

Firstly, FIs need to be able to detect changes in the status of their clients. These would include any changes in directors, offices or beneficial owners, as well as delistings and deregulations. Here adverse media tools can be used.

Secondly, FIs should use triggers to initiate refreshes on KYC outside the normal schedule. An example would be a client's new management team, which might indicate a change of corporate status or be linked to a new ownership structure. This should trigger an immediate refresh of the KYC file rather than waiting for the periodic check to come around."

Marc Romain, Chief Operating Officer, Risk Managed Services

Despite their diverse locations, their different types of financial institution and their varying roles within them, more than 700 decision makers who took part in our survey had a single clear message:
KYC compliance is a big issue and it is only getting more complex.

FIs annually devote considerable time to KYC for onboarding and monitoring ongoing changes and considerable time to understanding and implementing new KYC regulations, months of management and staff time that could without doubt be more productively spent.

Our survey makes clear the rising costs associated with KYC, the shortage of appropriately skilled staff and the lack of necessary technology to manage a constantly evolving set of regulations. The result is increased onboarding times than expected, expected to rise a further 18% in the year ahead, inconsistent requests for information and excessive client contact during the KYC process. At the same time, a lack of adequate ongoing monitoring is resulting in potential risks being missed.

Although in the short term both KYC costs and processing times will rise, there are reasons for optimism ahead: 76% of those surveyed recognize that regulatory change is a significant issue, and there is increased attention from senior managers. There is also a higher level of FI engagement with the regulator.

There is clearly room for global regulators to further clarify requirements and address some of the more complex challenges that exist. There is also a real opportunity for forward-thinking organizations to take a proactive approach to the regulatory environment and adopt the cutting-edge technology that is already available to streamline KYC processes. Those that do so will find themselves ahead of the regulatory curve and will be able to turn their KYC environment into a competitive advantage.

Research Methodology

Research was undertaken online in January and February 2016, with 772 decision makers in financial institutions (global banks, regional banks, investment banks and investment managers) and 822 decision managers across a representative selection of non-financial industries in organizations across a range of sizes. Research was also conducted in UK, Germany, South Africa, USA, Australia, Hong Kong and Singapore, where at least 100 respondents were sourced from financial institutions and another 100 from corporates in each of the seven countries, in order to conduct a robust global and in-country comparison of opinion from the two perspectives around the topic of KYC. Respondents were able to complete the survey in either English, German or Traditional Chinese. The general convention for rounding has been undertaken, so not all sums will add up to 100%.

ACCELERATI**ONBOARDING**

A UNIQUE SOLUTION TO THE KYC CLIENT ONBOARDING CHALLENGE

Our single, integrated KYC client onboarding solution delivers a centralized, scalable and truly innovative client onboarding platform and global KYC managed service: an unrivaled combination in the marketplace. Backed by the power of Thomson Reuters, no one has a better grasp of your business needs and market dynamics – or is better equipped to support your due diligence team and accelerate your ability to do business.

Thomson Reuters Org ID KYC Managed Service: A global solution developed for banks, investment managers and corporates to simplify and streamline counterparty due diligence and the ongoing maintenance of Know Your Customer (KYC) records – through collecting, classifying and verifying a client's identity - in line with ever-changing regulatory demands.

Thomson Reuters Client Onboarding: Automates the onboarding of new clients and ongoing refresh cycles through a centralized, scalable and cost effective solution, to facilitate compliance with regulatory demands. The solution combines data, document, rule, hierarchy, and workflow offerings in one platform.

For more information visit:
risk.tr.com/OrgID

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