

An Experian® white paper

Reducing Money Laundering Risk

Jim Lound

Product Director – Trust Services

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1. Introduction

Know Your Customer and anti-money laundering monitoring

This White Paper forms the basis of Experian’s response to the FSA’s Discussion Paper 22 – Reducing Money Laundering Risk.

2. The risk based approach

The risk based approach to anti-money laundering controls is intended to ensure that only proportionate costs are expended, whilst making the process effective without being an unnecessary burden on customers.

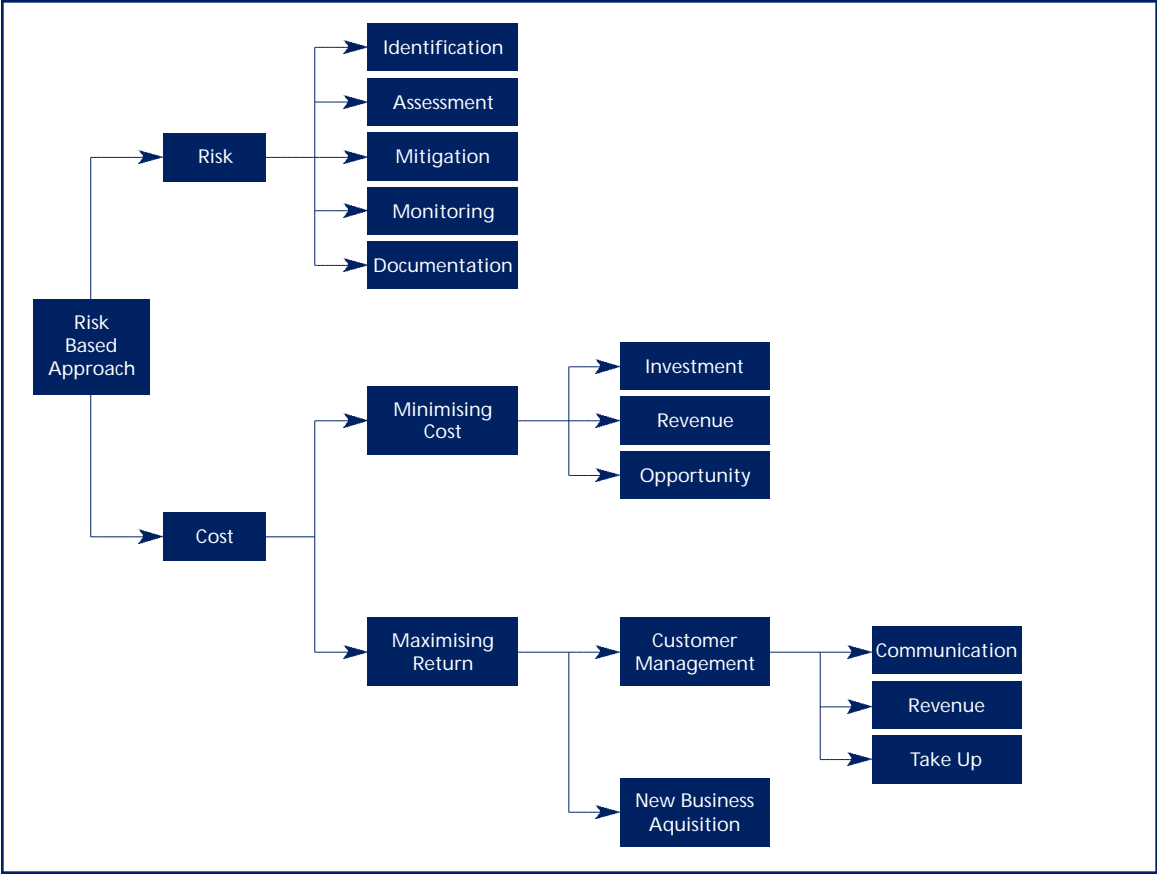
The risk based approach, therefore, requires a balance to be struck between the risk and the cost elements.

The risk element comprises:

- Identification
- Assessment
- Mitigation
- Monitoring
- Documentation

The cost element comprises:

- Minimising costs
- Maximising the return on the investment



Collectively, these elements will have an impact across the whole of an organisation, specifically:

- MLRO and compliance
- Fraud and credit risk management
- Operations
- Sales
- Marketing
- Finance

It is, therefore, imperative that the whole organisation views the anti-money laundering controls as being as much a part of the business process, both at acquisition and customer management, as any of the other core functions, e.g., sales cost of acquisition of new business.

Many currently view the effort involved as a hurdle to 'get over' which often results in a tick box mentality approach to the task by front line staff. As a result, existing checks are frequently seen as onerous and ineffective.

The challenge is to convince organisations to view the costs and effort associated with the implementation of anti-money laundering controls as a necessary check, in order to manage the day-to-day functioning and effective management of the firms' interests.

This will only be achieved if the process can be seen to be:

- Effective – finds money launderers
- Good value for money – worth the cost and effort involved

In today's increasingly remote business world, many financial services organisations rarely get the opportunity to interact with their customers, to learn about them and what they want from the relationship. The execution of money laundering checks, both at application and during the life of the relationship, results in the collection of valuable data providing an opportunity not only to ensure that the customer is who they say they are, but also establish their other needs.

3. Know Your Customer

The Know Your Customer (KYC) data should be viewed by the firm as a corporate data asset.

KYC is not just about anti-money laundering controls.

But anti-money laundering control is about KYC.

KYC is a data asset and is required by many of the day-to-day functions undertaken by the firm:

- Assessment of fraud risk
- Assessment of credit risk
- Defining the terms of business, e.g., the initial credit limit
- Defining the post service strategy, e.g., when to review the credit limit
- Upselling of products – existing facilities to existing customers
- Cross selling of products
- Attrition strategy

As well as the **assessment of money laundering risk.**

Whilst the KYC data required may vary depending upon the function, there is sufficient overlap of its uses to view KYC as a collective set of data.

The assessment of money laundering risk will require a set of KYC data that should be sufficiently common across all firms, to be able to define the minimum set. Depending upon the type of business, each firm should also have additional KYC data requirements relevant to its particular market and products.

KYC data should not be limited to the data available at the initial application stage.

KYC data needs to grow and be maintained in order to maximise its contribution towards the functioning of the firm. This includes the need to have anti-money laundering controls that are applied during the life of the customer relationship.

Some examples of KYC data elements and their potential contribution towards mitigating the firm's risks and maximising profit:

The level of confidence that the identity exists	Fraud and money laundering (ML) risk
The level of confidence that this is the person associated with the identity	Fraud and ML risk
The customer's income and spending patterns	Credit risk, ML risk, terms of business, post service strategy, upselling, cross selling, attrition strategy
The customer's existing account holdings	Credit risk, ML risk, terms of business, post service strategy, upselling, cross selling, attrition strategy
Is the customer likely to receive overseas transfers?	ML risk, cross selling, attrition strategy
The level of confidence that the application data has not been manipulated	Credit risk, ML risk
The customer's time at their current address	Credit risk, ML risk, cross selling
The customer's time in their current employment	Credit risk, ML risk
The customer's type of employment	Credit risk, ML risk, cross selling

The term KYC has become synonymous with the hurdle that is seen to be anti-money laundering controls.

If the term KYC was changed to Customer Relationship Management (CRM) data, then perhaps this would widen the interest within a firm towards making the CRM data as comprehensive as possible, in order to enhance all customer interfacing activities.

Customer facing activities are not just limited to the Sales function; for example, ongoing credit risk management also needs to understand the customer's current situation and the behaviours that might ensue.

It would be seen that the cost of acquiring and managing the KYC data becomes more acceptable with the current perceived burden of responsibility being lifted from the shoulders of the MLRO and Compliance.

In short, an holistic view of customers is essential to any organisation seeking to achieve the maximum opportunity from the relationship in terms of maximising sales and minimising risk. The requirements to support such a strategy are the same as to ensure that the customer is not a criminal and / or money launderer.

Any additional costs specifically associated with the KYC requirements should be minimal, possibly only associated with the retention of records and audit trails. Even then, responsible lending requirements and the needs of analytics and modelling have considerable overlap.

4. Monitoring

Being alert to how a customer is using a firm's products and services, and therefore to signs of money laundering, requires the ongoing monitoring of transactions associated with the customer. To be effective, the monitoring of transactions cannot be undertaken in isolation of the KYC data. It is, therefore, essential that the KYC data is maintained and is as up-to-date as possible.

A transaction viewed in isolation may be regarded as medium risk but, when associated with the up-to-date KYC data, it may indicate an increased risk. For example, the customer may have changed residency but has not directly informed the firm.

A high risk transaction can reactively trigger a review of the up-to-date KYC data. Conversely, monitoring significant changes in the KYC can proactively trigger a review of the transactions over a pre-defined period of time.

5. Use of electronic data

The use of electronic data in the validation and verification of identities, and the distillation of this data into a risk index, is already recognised as a valid method of identity checking in the JMLSG guidance notes.

This provides a more robust and consistent measure at a fraction of the cost when compared to the use of documentary evidence. The use of electronic data also improves the customer experience when opening new facilities with firms.

The extent of the reduction in costs will vary between firms, but to give an indication, savings of 90 per cent can be achieved when compared to the cost of appraising, processing, storing and retrieving documentary evidence.

From a customer service perspective, the use of electronic data provides a less intrusive and more convenient method of assessing the confidence in their identity.

In a risk based environment, where the extent to which anti-money laundering controls are applied need to be balanced against the costs incurred, the use of electronic data provides a significant opportunity to reduce the risk of ML activity occurring.

This tangible cost reduction and improved productivity of the firms' human resources should be of interest to the Operations and Finance Directors.

However, there is evidence to suggest that in some firms there is still a reliance on documentary evidence where the main justification is that the documents are tangible, the user can see and touch them and it has been accepted practice to use them for many years, even though there is a recognition within the firm that this practice is questionable and expensive and may contain no real value anyway.

Electronic data sources can be used to populate and maintain KYC data throughout the customer relationship. The use of electronic data procured externally from organisations such as Experian, can provide data that relates to the customer's wider interaction with society, which the firm may not be aware of.

Furthermore, the benefit of using information from a third party rather than from the consumers themselves has already been proven in the credit and risk environment.

As mentioned previously, KYC, as a corporate data asset, can be used to satisfy a whole range of functions associated with managing the customer relationship.

Sanctions data is another source of electronic data. The sanctions data needs to be checked at the time of the initial application and at regular intervals throughout the customer relationship in order to monitor any significant changes or new additions to the data.

Many organisations use Behavioural Scoring and monitoring techniques to understand the changes in a consumer's profile and how that might impact on their ability to service facilities in the future. There is little difference in the needs and processes required for monitoring unusual activity of a potentially criminal nature. Again, such techniques are in common use by Experian clients utilising the tried and tested online and batch access to sanctions data at the initial application stage, and as part of a regular monitoring service.

6. Effective customer management

The ongoing application of anti-money laundering controls should not be viewed as an isolated event. It should be viewed as an integral part of the customer management activity.

Making contact with a customer can be an expensive business and, therefore, making effective use of the opportunity is essential. Knowing when to contact a customer, in order to maximise the revenue opportunity and to manage the various risks effectively, including the ML risk, is the key to successful customer management.

With regards to the anti-money laundering controls, the period of elapsed time between reviews needs to be proportionate to the risk. Wire transfers, for example, would need online checks against the sanctions data at the time of the transaction, whereas a low risk product may need to be reviewed only once a year.

Using external electronic data sources to trigger the contact with the customer is a very cost effective and efficient way of updating KYC data. This is particularly true when key life events can be identified that may pose a significant risk in ML terms but, alternatively, may present an ideal opportunity to cross sell and upsell products.

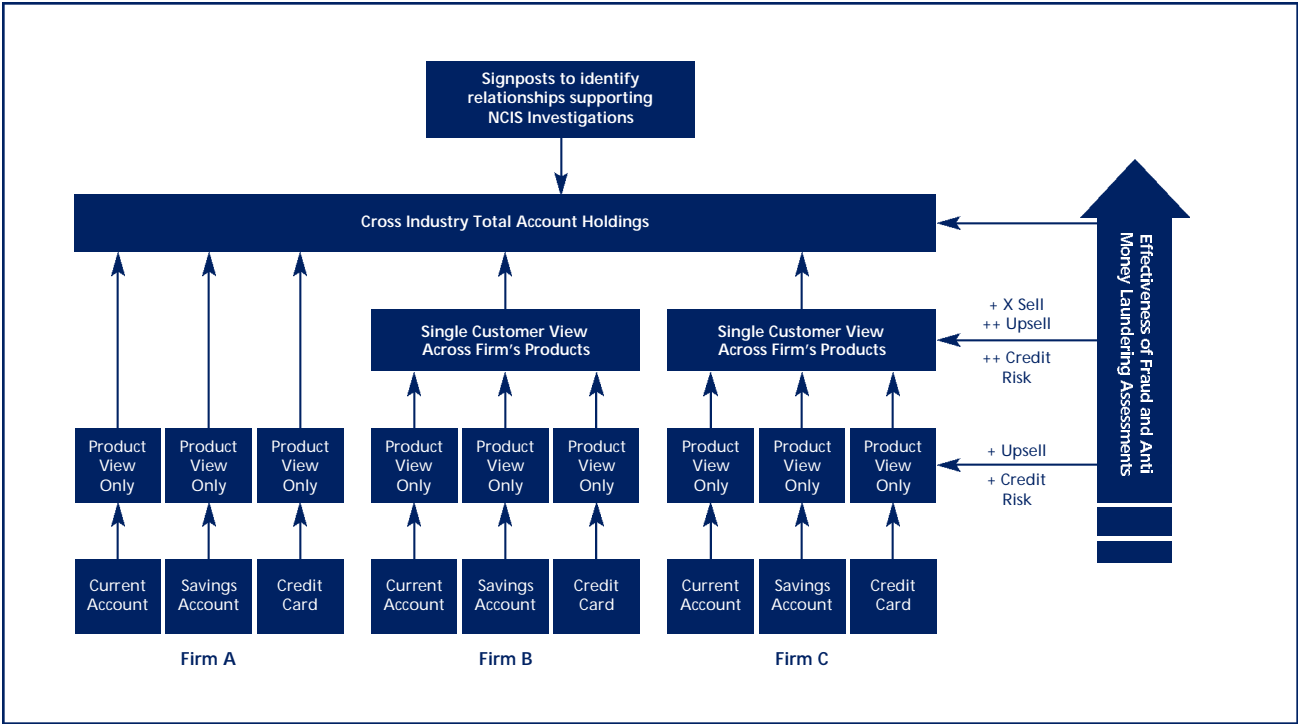
For firms that have more than one product, knowing a customer's account holdings is vital in KYC terms both from a ML perspective e.g., (" why does this customer have 31 investment accounts?") and from a cross selling perspective e.g. (" why are you offering me this account when I already have one?").

For those firms that do not have a customer database, the use of a third party data processor can provide a platform on which to create a single customer view and incorporate this within a customer monitoring capability.

Having established the ability to create a single customer view within a firm, from the ML risk perspective, the ability to create a high level single customer view of an individual across the firm would be a great asset enabling the firm to ask " why is this individual opening their 28th bank account?"

Having established a high level single customer view, investigators such as NCIS could use this view to provide a series of signposts to know where to look when investigating an individual where a suspicious report has been lodged.

The following diagram is a representation of the cross industry total account holdings hub.



This approach would contribute towards more effective fraud and anti-money laundering controls as the view of the individual moves from a restricted single product view, where the only data available is associated with the activity relating to the product, towards a complete view of the individual across the firms.

At the level of the single product view, the customer management capabilities are effectively restricted to upselling. The credit risk assessment would not be able to take into account other account holdings that, in the case of investments, may indicate a reduced risk.

At the level of the single customer view within the firm, the customer management capabilities in relation to upselling are significantly improved and cross selling becomes a viable activity. The credit risk assessment capability is also enhanced.

Experian already hosts the Credit Account Information Sharing scheme on behalf of the financial services industry. Experian can, in addition, host the cross industry total account holdings hub.

Furthermore, scoring and modelling techniques available from experienced providers such as Experian can facilitate an effective and, from the organisation's point of view, a cost effective solution.

7. Conclusion

In conclusion, the key messages are:

- Anti-ML controls need to be viewed as a core element of the firm's business
- KYC data and processes should be viewed as a firm's corporate asset
- KYC is not just about anti-money laundering controls
- KYC data contributes towards the monitoring process
- KYC and monitoring play a vital role in the anti-money laundering controls
- Electronic data provides a cost effective and robust source of KYC data
- Identity checks using documentary evidence are expensive and ineffective
- A single customer view within and across firm is a vital element of maximising return
- The key to effective prevention of crime and money laundering is to reposition KYC into a total customer management strategy designed to support the requirements of all concerned thus:
 - the lender maximises profit
 - the consumer maximises service and gets the advice and products they want and need
 - the Regulator is comfortable that effective controls and checks will prevent the use of the UK financial services sector for the support and perpetration of criminal activity and, specifically, money laundering.

The UK has the opportunity to demonstrate to the EU and beyond that it has the capability and the resolve to tackle not only the problem of money laundering but also the broader problem of financial crime.



Riverleen House
Electric Avenue
Nottingham
NG80 1RH
United Kingdom

T: 44 (0) 115 992 2849
F: 44 (0) 115 992 2296

www.experian.co.uk

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