

An original approach to the KYC system

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« Know Your Customer », also known as KYC, refers to the process by which financial institutions and regulated companies inform themselves about their clients before doing business with them, through due diligence and the application of bank regulations. This includes being able to check, among other information, the identity of the prospective client, its activities and sources of revenue, and its background and financial structure.

Flaws in KYC procedure may lead compliance systems to collapse and generate both operational and financial losses. It is for this reason necessary for the managers of companies subject to such risks to determine the objectives of KYC procedures and define the attributes on which they should be based. The framework for this attribute-based approach is the “attribute-color,” a concept adaptable to the analysis of KYC systems.

The “attribute-color” concept associates colors to different attributes, ideas, and associated words as indicated in the chart below:

Color	Attribute	Associated ideas	Associated words
Red	Dynamism	Ability to change and keep ahead of the curve, continually assessing priorities and how to put them to work	Goals, objectives, risks, priorities, decisions, syntheses, directions, values, convictions, confidence, precision, straightforwardness, brevity
Magenta	Optimization	Ability to improve processes, operations	Improvement, perfecting, enhancing, better, higher, more, follow-up, reinvest
Blue	Coherence	Ability to follow a determined path, to maintain a course of action with accuracy	Logical, method, anticipation, accuracy, plan, procedure, rigorous
Cyan	Open-communication	Ability to relate – to assimilate - facts, ideas, partners	Exchange, links, sharing, relationships, listening, networks
Green	Adaptation	Ability to react to demands, to the context or clients	Creative, reactive, flexible, mobile, agile, pragmatic
Yellow	Harmonization-Complementarity	Ability to reach an agreement, to learn from differences	Alternatives, diversity, variety, contrast, opposition, agreement, consent, tension, convergence, difference, dissonance, conflict, deepening, enrichment, heterogeneous

According to this attribute framework, we can deduce some requirements concerning the advantages of a KYC system.

Verification

The main goal of « Know Your Customer » systems, as represented in figure 1 below (including actors, organization, process, data, application, and technology), is to collect and verify relevant information in order to ascertain the identity and the background of a third party. This has become increasingly important since the passage of laws such as the Bank Secrecy Act and the USA PATRIOT Act. Indeed, regulators expect financial institutions to help prevent identity-theft fraud, money laundering, and terrorist financing. Typical sources of information are records on regulators' websites, cross-checked with lists of those known to have committed fraud maintained by official financial institutions. Outside the US, similar legislation governs this aspect of KYC, such as the Proceeds of Crime Act in the UK or MiFID guidelines in the EU.

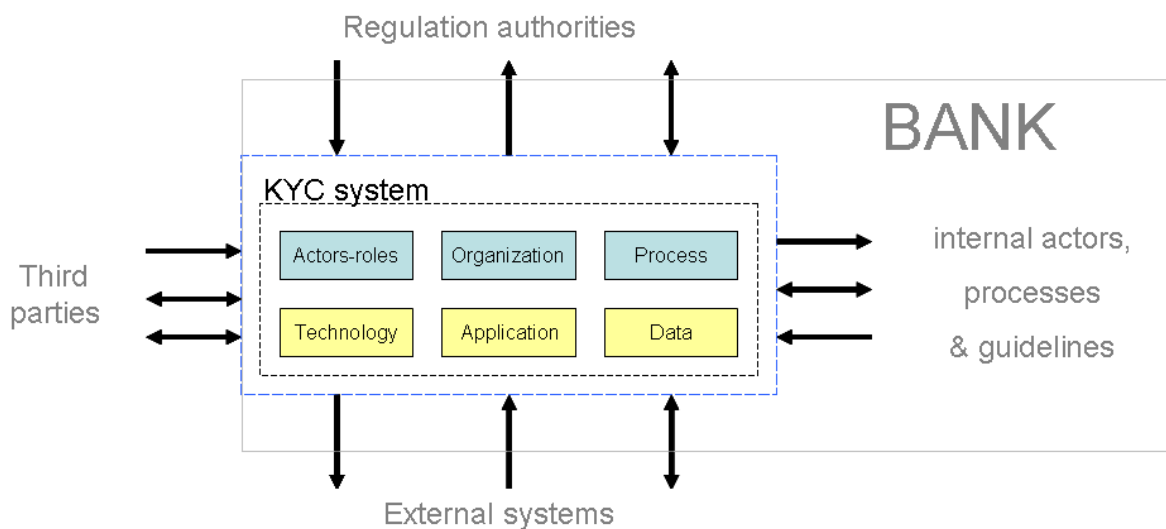


Fig.1 KYC system

Maintaining Accuracy

Once a relationship with a third party has been created, the other objective of Know Your Customer is keeping accurate data on file and updating them periodically to ensure the integrity of the relationship. This means checking with other firms and agencies that all the information on file is up to date, as well as requesting new documentation when changes in legislation occur. Doing so is a prerequisite to maintaining a comprehensive KYC system.

Integrating the System

In order to meet these functional requirements and to combine efficiency, effectiveness, and cost-control, the KYC process should be seamlessly integrated into existing procedures within the firm itself. It has to be optimized so that relationships with clients can be monitored and reliable knowledge of counterparties can be maintained. It should be noted that KYC has the same goals as Third-Party, Compliance and Customer Relationship Management systems:

- Third-Party manages client relationships solely from a data referential point of view.
- The goal of Compliance is to ensure conformity with clearly defined rules or laws. It has a wider purview than KYC.
- CRM is designed to manage relationships with customers or prospective customers, using a marketing or sales approach.

Adapting to Changing Environment

In order to add value to the different systems already in place, KYC should be made to complement them without interfering.

This stresses the importance of managing interactions and communicating with all the actors involved, both inside and outside the firm. To reach these objectives and comply with evolving regulatory guidelines, the KYC system must be set up to interact smoothly and efficiently with its environment, and to deal with a wide range of information. Counterparties may vary greatly, in terms of the nature of their business, structure, and location. In addition, the business environment of the bank or financial institution may itself change. A key aspect when considering a KYC system is its ability to adapt and remain flexible.

Last but not least, to ensure that there are no redundancies or inconsistencies in the data system referential, the KYC system should include periodical cross-checks of the database. Internal processes should be joined with dynamic management of the client relationship and proactivity with regards to regulations in order to monitor information quality and make sure the latest regulations are followed despite a changing regulatory climate. A key to ensuring this happens lies in comprehensive and continuous training of employees so that they understand the KYC environment and its impact on the procedures and tools employed by the firm. Taking into consideration all the aforementioned priorities will ensure an optimal KYC system.