CONQUERING COMPLIANCE

SHINING A LIGHT ON CUSTOMER DUE DILIGENCE

dun & bradstreet

Contents

Foreword

In a world shaped by geopolitical upheaval and economic uncertainty, the role of the compliance function has never been more vital to banks and other financial organisations.

Guarding the business as they do from a multitude of ethical, regulatory and financial threats, compliance officers serve as the first line of defence - not just to the bank's bottom line, but its reputation as well. And while customers themselves may not be aware of it, the compliance function is largely responsible for shaping their first meaningful interactions with the organisation.

Compliance teams shield the business from threats, but their ability to do so is defined by the information they can gather on prospective customers. From points of origin to beneficial owners, compliance officers do everything they can to ensure that new clients are genuine, reputable and good for the business.

The anti-money laundering fines levied by the Financial Conduct Authority demonstrate the importance of implementing a robust Customer Due Diligence (CDD) process. No organisation is 100% safe from risk all the time. As criminals become more sophisticated, the compliance function needs to evolve in order to keep pace.

To learn more about the challenges facing these teams in today's finance industry, and to see how well prepared they feel for an increasingly complex future, Dun & Bradstreet surveyed 100 compliance professionals from across the UK banking sector.

Detailed in the following pages, the results tell the story of a department labouring under the dual demands of regulatory compliance and business growth. Cast both as guardian against risk and accelerator of new revenues, compliance professionals are being stretched further than they ever have before.

This report explores some of the greatest challenges they face, as well as some of the potential solutions to those tests.

As we will come to see, the extent to which they succeed will likely play a fundamental role in shaping the future of their business.

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Global Compliance Solutions at Dun & Bradstreet

Drawing the lines of defence

It has been more than a decade since the 'three lines of defence' (3LOD) concept began to gain popularity as a risk management model for financial services institutions.

The financial world has undergone seismic shifts since financial regulators began to promote 3LOD as an effective tool in the fight against operational risk. But despite those changes, the fundamental tenets of 3LOD remain the same: build and maintain lines of defence via operational management, risk management and internal audit.

Support and, indeed, enthusiasm for 3LOD will vary from organisation to organisation, and from person to person. For every fervent advocate of the approach, one is just as likely to find detractors who are equally fierce in their criticisms - opinions around which can range from the model's overall effectiveness to whether or not a 'post-mortem' audit can truly constitute 'defence'.

While views may differ, though, few would contest that 3LOD is now the primary approach to tackling financial risk - a sentiment widely shared by respondents to this study. When asked to outline their organisation's CDD approach when onboarding new customers, well over a third (40%) of the financial professionals surveyed said that they follow the 3LOD approach.

Although this result sounds good, relatively few organisations are proactively seeking to enhance their level of sophistication around CDD. While there are those who centralise and manually process customer applications (14%), less than one in 10 have taken steps to automate procedures (7%).

40%

of the financial professionals surveyed said that they follow the 3LOD approach

Not only does this mean that the vast majority of financial services organisations are continuing to divert unneeded time and resource towards CDD, but they are also exposing themselves to the inherent risk that the data they are dealing with - whether centrally or by department - could decay, be misinterpreted or simply be inaccurate to begin with.

The problem here, rather than being one of resistance on the part of compliance teams, is almost certainly cultural. An enhanced, more efficient CDD process can present financial services organisations with a wide range of benefits, even turning compliance into a platform for growth. But communicating that to the wider, highly sales-focused business is undoubtedly tough.

Juxtaposed with front office enhancements that have a clear impact on the customer experience - and therefore sales and growth - it is easy to understand why compliance professionals might find it difficult to garner support for improvements to their own essential systems.

Faced with the decision to invest in new customer-facing tools like apps and digital services, or to refine and enhance the compliance process, it is not difficult to imagine where many businesses will place their bets.

There are some promising signs, though. Amongst those banks and financial institutions that have automated their CDD process, around half (43%) have opted to combine their own internally developed systems with those from a third party, giving them access to a much broader range of data. Of those who currently operate a centralised, manual process, 100% say that they are exploring third party tools in order to automate some or all of the operation.

100%

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Slow your customer?

The onboarding process is one of the most critical moments during the customer relationship. Not only does it constitute a new client's first meaningful contact with an organisation outside of the sales or marketing cycle, the onboarding process is also responsible for shaping their ongoing expectations about the quality of service that they can expect.

While CDD serves to defend organisations, when things go wrong it can throw the onboarding process out of balance. From delays that occur while detailed information is being hunted down to repeated requests for documentation based on erroneous assumptions, a poor CDD program can have a significant detrimental impact on the customer's first contact.

Ensuring the organisation's security is, of course, paramount. But safety shouldn't prohibit the provision of a first-class customer experience. Establishing a balance between safeguarding the organisation and satisfying the customer is key.

For more than half (54%) of financial organisations, it takes between three and six days to onboard a new business customer. Well over a third (44%) say that it takes one or two days, while a very small minority (2%) assert their ability to create a new account on the day of application.

A similar situation exists around the issue of beneficial ownership. Asked how long it might take them or their team to identify an entity's beneficial owner, most (67%) compliance officers suggested that it could take up to two days, while more than a quarter (27%) expanded that timescale to between three and four days.

Taken at face value, there seems little to be alarmed about here. None of those surveyed suggested that it would take a week or longer to onboard a new account, while just one per cent put identification of a beneficial owner at five or more days.

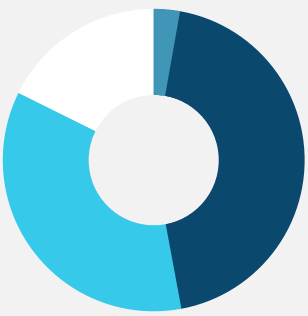
At the same time, there is clear open ground for any bank seeking to establish competitive advantage in terms of their ability to swiftly and securely bring new customers onboard. Any delay - and particularly an unnecessary one - risks lengthening the time to revenue and eroding the customer experience.

Regulation might demand enhanced scrutiny from compliance teams, but there is a clear and compelling need for the function to respond to that challenge with a smarter, slicker process. Evolution of this kind would undoubtedly benefit the organisation as a whole, a view shared by many of the compliance professionals surveyed.

Asked what the impact of automation would be on the customer onboarding process, respondents showed considerable support for answers ranging from faster times to revenue (60%) and improved customer experience (56%) to reduced duplication (50%) and cost savings (43%).

Standing in the way of this more efficient future, though, is the attitude that many organisations demonstrate towards the use of external data. Just a third (36%) say that they have made third-party data an integral part of their customer screening activities, with the majority (58%) stating that - while they do use it - it only amounts to a "small part of the process". Five per cent said that they use no external data at all.

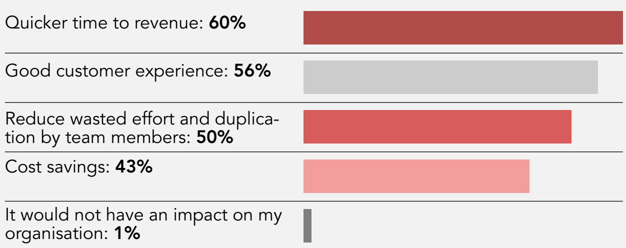
The net result of this is that many banks and other financial institutions likely experience longer onboarding times than necessary. By failing to adequately assimilate third-party data with their own, they run the risk of extending the onboarding process and losing out on the benefits that they so widely recognise.



On average, how long does it take your organisation to onboard a new business account?

- Less than one working day: 2%
- 1 - 2 working days: 44%
- 3 - 4 working days: 42%
- 5 - 6 working days: 12%

If the CDD process for onboarding is automated, what impact do you think this would have on your organisation?



Reporting risks

Ensuring that a bank or financial institution meets its regulatory requirements is the compliance department's raison d'être. Defending against malicious intent isn't only necessary from a legal or ethical point of view though: it also showcases the bank's commitment to responsible business and its ability to protect the interests of genuine customers.

No matter whether it is at the opening of a new customer account or midway through a multi-year relationship, though, mitigating an organisation's exposure to risk is no easy task. A huge range of factors - from geographic location through to changing ownership - can make it difficult, if not impossible, for banks and financial services organisations to be certain that an existing or potential customer presents no risk.

It is a dilemma with which the majority of compliance professionals surveyed for this study readily empathise. Around half of respondents (45%) say that they find it "fairly" or "very" difficult to monitor the compliance status of their customers on an ongoing basis. Less than a tenth (8%) suggest that it is "very easy".

The ease or difficulty with which compliance personnel can keep track of a client's status will, naturally, vary. Not every customer's circumstances are the same, and while it might be relatively simple to ascertain the reliability of those closer to home, the same may not always be true of organisations in other parts of the world.

While the specific challenges facing every compliance team will be unique, there can be little doubt that any difficulties experienced when trying to stay up to date with customer compliance cause complication elsewhere too.

This is most apparent when looking at customers that prompt compliance teams to take action. Two thirds (67%), for instance, say that it would take between 24 to 48 hours to identify and compile a report on a client that posed a regulatory risk. Around half that number (28%) suggest that it would take longer still - between three and four days.

Reporting timescales of this length will have different consequences depending on where they occur in the customer lifecycle. A delay to an application caused by the creation of a risk report would almost certainly create tension between sales and compliance teams, while the detection of risk when a customer is already transacting puts existing revenues in jeopardy.

Despite this tangible threat to the wider organisation's wellbeing, most compliance professionals say that the creation of risk propensity scorecards during the onboarding process is pursued erratically at best. Over half (55%) say that their organisation only "sometimes" creates propensity data models when bringing new customers on board.

Although a third (37%) suggest that they carry out this procedure as a matter of course, many are clearly either unconvinced by or unaware of the benefits of such an approach.

How easy or difficult is it for you to monitor the compliance status of your business customers on an ongoing basis? This includes identification of financial crime, shadow companies, tax evasion and fraud

- Very difficult: 12%
- Fairly difficult: 33%
- Indifferent: 24%
- Fairly easy: 23%
- Very easy: 8%

28%

of compliance teams say that it would take between three and four days to identify and compile a report on a client that posed a regulatory risk

A complex future

The challenges facing compliance teams around CDD are many and varied. From delays to customer onboarding and difficulties in monitoring compliance to the absence of data insight where it is needed most, financial institutions are being exposed to a range of negative impacts as they seek to fulfil their regulatory duties.

The nature of these challenges is such that they pose a twofold threat. First, and the most serious in terms of scale, is the risk of a serious regulatory breach that creates significant financial and reputational repercussions for the business. The second, but perhaps more likely, is the danger that a sluggish CDD process presents to the customer journey.

Compliance professionals are only too cognisant of the latter of those threats. Three quarters (75%) of respondents to this study agree that CDD-related delays during the onboarding process have a negative effect on the customer experience.

That figure in isolation would be cause for concern. But it is particularly worrying when we also consider that respondents say that, over the past five years, it has become increasingly difficult to onboard new customers (51%), they have had to build a bigger team in order to cope (32%) and that it is getting harder for their organisation to remain compliant while balancing the onboarding needs of the business (18%).

Caught, as they are, between the proverbial rock and hard place, compliance professionals find themselves torn between meeting their regulatory duty and serving the business as expected. Worse still, they are tasked with doing so without the insights that could help to lighten the load.

Indeed, many (55%) say that their response to this duel responsibility has been to invest in technology in an attempt to help them cope. When we see so few pursuing automated or insights-driven approaches to CDD and customer onboarding. However, when we see so few pursuing automated or insights-driven approaches to CDD and customer onboarding, it is difficult not to see investment in technology as an additional layer on an already complex infrastructure. Only by injecting smarter, more current data into such a system can the real benefits of technology be realised.

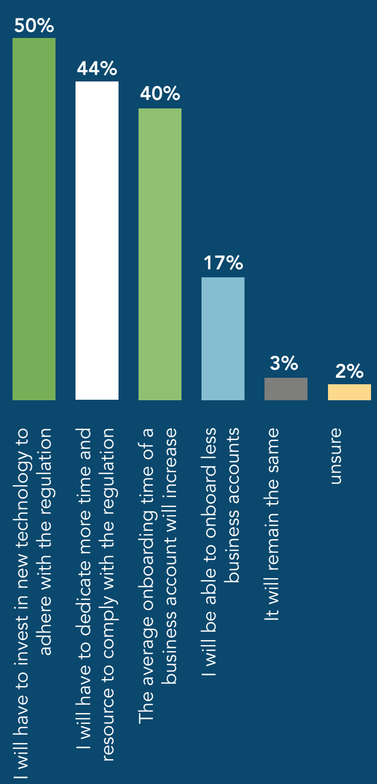
As time goes on, that realisation will become ever more essential according to respondents. Looking ahead to the coming five years, around half (44%) predict that they will need to dedicate more time and resource in order to comply with CDD regulation, with similar numbers saying they expect customer onboarding times to increase (40%). Some even foresee a future in which they will be forced to onboard less business (17%).

Again, technology is seen as the solution to these tests. Half of the compliance professionals are planning to invest in more new technology to help them overcome this hurdle. But no matter whether they are looking towards future technologies such as Peer-to-Peer Analysis and AI, or simply building on existing infrastructure, the overriding need for better data integration continues to apply.

For many, the timeframe they have to implement these changes is shrinking. Even in just the next 12 months, significant numbers believe that it will be harder for their organisation to comply with financial regulation (49%), that additional regulation will make it harder to onboard customers (44%) and that growing sophistication amongst the criminal element will make bad business increasingly difficult to identify (35%). Just under a quarter (24%) believe it will be more difficult to remain compliant as their organisation grows and only 4% do not have any concerns.

As global megatrends take hold and the finance industry continues to become more tightly regulated, there has never been a greater need for organisations to rebuild their compliance foundations and begin planning for a better-informed future.

What impact do you see CDD regulation having on your business in the next five years?



Conclusions

Compliance professionals within financial services organisations are readying themselves for a more complex, uncertain future. A growing regulatory burden threatens to meet the demands of the wider business head-on, creating a swell of pressure around the compliance function that carries the potential to increase risk and diminish the customer experience.

There are many tactical issues that seem to be preventing the compliance function from operating as effectively as it could. Smarter application of robust data could help to tackle many of these obstacles, as could a greater emphasis on combining the businesses' own data streams with those generated by third parties. But the compliance function does not exist in isolation from the rest of the organisation.

In order to create a CDD process strong enough to meet the demands of tomorrow, banks and financial institutions need to appreciate that a healthy compliance function has an impact beyond the back office. Implementing a strategic, data-driven approach, can help build an environment in which the compliance and growth needs of the business are aligned.

Doing so means focusing on the following issues:

Using automation to alleviate the burden
Timescales around onboarding of new customers and reporting on potentially risky prospects suggest that compliance teams are struggling under the burden. With an expectation that this situation will only deteriorate further over the coming years, an intervention is needed now in order to defend the interests of the business.

Automation of customer onboarding - identified as carrying a wide range of benefits but used by relatively few - is one potential solution. With the vast majority of new customers unlikely to present a risk to the bank or financial institution, data-based automation would help to free up valuable compliance time, allowing the function to focus on high-risk or complex customer accounts.

Demonstrating the value of effective compliance to the business
Risk management and rapid growth need not be mutually exclusive. An efficient CDD process that allows for the swift and uninterrupted onboarding of new customers should be as compelling to the sales team as a new app or service that draws a prospect's attention in the first place.

If compliance teams are struggling to gain the leverage needed to support investment into the tools and technology they need to enhance their core processes, showcasing the impact that a more refined CDD function can have is a key avenue to explore.

Expanding the focus to encompass more than just technology
For many compliance professionals, technology is the go-to response when seeking to solidify their response to the pressures of a more complicated CDD and compliance environment. Many have invested in it already over the past few years, and many plan to do so again.

If this technology is to deliver true return on investment though, it must be underpinned with a more thorough appreciation that a system can only be as powerful as the information that flows into it. Compliance teams need to ensure that the quality of the data they have access to is as robust as possible in order to ensure that the technology they invest in does not become just one more layer in an already complex infrastructure.

Methodology

Research for this study was undertaken by Censuswide, a respected independent research company. Responses were gathered from 100 compliance, legal and operations professionals within UK banks and financial institutions.

The online survey was carried out in November 2016.

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