AML/KYC TRACKER™

Where The UK Fails

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WHAT'S INSIDE

Financial institutions (FIs) must walk a fine line to keep their customers safe while avoiding frictions that will scare them off. A recent study by software company Fenergo found that banks consider improving customer experiences with better data and document capture tools to be the most important issue they need to address, followed by know your customer (KYC) regulation compliance.

FIs are also tapping anti-money laundering (AML) solutions. Banco CTT is hoping such products will reduce the frequency of false positives — when a system prompts an FI to investigate legitimate transactions — which can create major headaches for customers.

Despite the customer pain points that can be incurred in the pursuit of security and compliance, robust AML procedures can make all the difference in winning customers over and avoiding regulators' wrath. This is a lesson that seven Indian banks should take note of, as they recently received fines for regulation noncompliance, including, in some cases, AML and KYC failures.

Avoiding fines isn't the only reason companies seek stronger AML procedures, though. Demonstrating tight compliance can be important in gaining customer trust. That's the case for firms in the cryptocurrency space, many of which hope to see transaction monitoring solutions improve stablecoin issuers' reputations, better control against value volatility and encourage cryptocurrency adoption.

Diligent regulatory compliance has a lot of value for FIs and other businesses. But, despite knowing they need to keep compliance measures up to snuff, some international companies still struggle to manage the varying regulations in different operational markets.

AROUND THE AML/KYC WORLD

Some solution providers are now helping FIs combat this issue. Fenergo, for instance, recently announced a cloud-based regulatory rules offering with a plug-and-play design, enabling FIs to integrate a repository of regulatory rules for both local and global KYC, AML and other requirements into their existing digital platforms.

Global identity verification solutions firm Trulioo is also helping companies handle compliance processes while bringing services into new markets. Its automated due diligence product helps FIs with KYC and AML checks, and was extended this year to cover consumers in the Czech Republic, Poland, Slovakia and, most recently, Bangladesh.

Even non-FIs are reconsidering their due diligence approaches. Amazon is among several mobile wallet

operators affected by recent policies in India, which prevent consumers from loading money onto their mobile wallets unless the companies affected provide more robust KYC processes than previously administered. Some observers believe that Amazon may be trying to sidestep the issue, which impacts its Amazon Pay mobile wallet, instead promoting a solution that facilitates transferring payments directly between bank accounts using India's Unified Payments Interface (UPI) and having the banks handle the KYC.

DEEP DIVE: AN AUTOMATED APPROACH TO THE $2T GLOBAL MONEY LAUNDERING PROBLEM

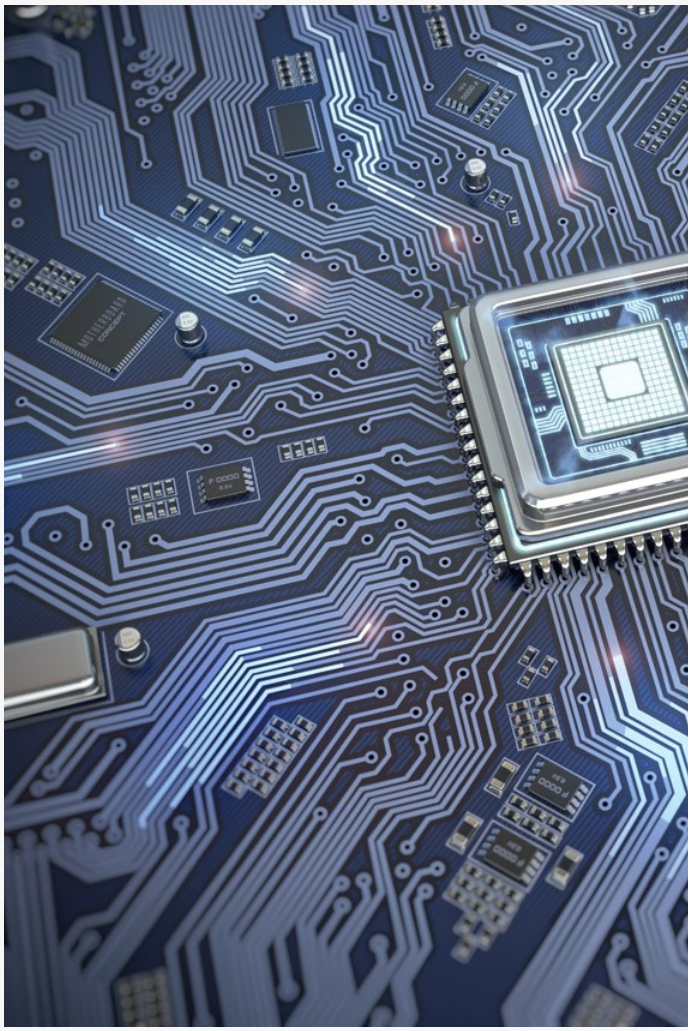
FIs face increasing struggles as they work to fight money laundering and adhere to regulations. Fast-paced, globally interconnected digital ecosystems and inconsistent market regulations both present immense challenges for those seeking to maintain robust AML procedures and compliance. FIs can't afford to let illegal activity go unchecked, however, or they will suffer fines for noncompliance.

As they invest in AML strategies, banks and other firms must be sure they're making their money count. This month's Deep Dive (p. 16) explores FIs' regulatory challenges and how automation tools like artificial intelligence (AI) can help.

TRACKING MONEY LAUNDERING CHALLENGES ACROSS THE POND

Watchdog organizations say the U.K. is falling behind on restraining money laundering, with hundreds of billions of pounds in criminal proceeds reportedly laundered through the nation's banks and subsidiaries each year. High-end schemes tend to go relatively unchecked, too, with funds hidden in digital transactions in which professionals like lawyers, accountants and investment bankers often unwittingly lend credibility to and enable the complex processes that cover criminals' identities.

The U.K. also often fails to actively investigate or enforce AML compliance among banks and other corporations, according to Susan Hawley, director of policy at anti-corruption nongovernmental organization Corruption Watch UK. In this month's feature story (p. 7), Hawley dives into just-released research on the weaknesses troubling the U.K.'s regulatory system, including conflicts of interest among regulators, timid noncompliance penalties and the economic philosophy that may be encouraging all of it.



EXECUTIVE INSIGHTS

The Cyprus Securities and Exchange Commission aims to adopt aspects of the EU's AMLD5 directive for regulating crypto exchanges. What challenges exist to achieving a more global standard for cryptocurrency AML regulations?

"Cryptocurrencies are a fairly new development. Deploying AML regulations to help prevent money launderers from using crypto to place, layer and integrate proceeds of crime is even more recent.

Regulators are under pressure to understand different facets of the associated technologies, as there are numerous models and systems and the technology is evolving quickly. There are currently over 2,000 different crypto assets and, with significant investment and developer interest ongoing, keeping up with the technology is difficult.

Even within jurisdictions, regulatory oversight is problematic, as fundamentally different use cases fall under the purview of various regulatory bodies. Combine this with the cross-border nature of crypto, where exchanges can [happen] anywhere on the planet and transactions can involve multiple jurisdictions, [and] the lack of compliance, supervision and enforcement standards become more pronounced.

For many cryptocurrencies and exchanges, anonymity is a feature. ... These systems hide transactions, making AML procedures difficult.

While the [Financial Action Task Force] will include standards for crypto in a June 2019 update, [they will be] non-binding recommendations that will take time to filter through to regulatory requirements. As regulators become more acquainted with the technology, its uses and how best to oversee it, a framework for global standards will eventually emerge."

Refugees need banking services, but frequently don't have the identification documents financial institutions seek for their KYC checks. Which solutions could help tackle this problem?

"Technology alone cannot solve this problem. There must be a concerted effort between humanitarian agencies, governments, regulators and financial institutions to find methods to ensure that refugees aren't financially excluded.

Recent refugee crises — particularly the displacement of Syrian and Somalian nationals — have shown that large numbers of refugees never had identity documents to begin with. The [United Nations Humans Rights Council] already uses technology to build biometric profiles of refugees. These profiles, in conjunction with one-on-one interviews with refugees, are used to build the refugees' identities. With the use of APIs, financial institutions can securely access this data and verify their identities.

Regardless of whether the refugees lost their IDs during the evacuation or never had them in the first place, it's likely they had mobile phone accounts in their home countries, given the rising penetration of mobile carriers in remote corners of the world. Data in possession of these mobile network operators goes a long way [toward] establishing the identity of refugees, [and] user and transaction data, in particular, can be used as a foundation to build a credit history.

A risk-based approach to KYC, based on transaction levels and volume of use, can help refugees gradually build a footprint in the financial system."

Zac Cohen
general manager at Trulioo

5 FIVE FAST FACTS

64%

Portion of cryptocurrency laundered in 2018 through digital asset exchange deposits and trades

1%

Estimated share of intercepted proceeds from financial crimes

23

Number of countries blacklisted by the European Commission for their AML and CTF framework deficiencies

90%

Estimated portion of false positives flagged by AML software at banks

7

Number of banks recently penalized by the Reserve Bank of India for regulatory noncompliance

FEATURE STORY

Where The UK Fails

ON ANTI-MONEY LAUNDERING

> There's a systemic problem within the supervisory regime in the U.K.

Susan Hawley
director of policy at Corruption Watch UK

Money laundering is a major threat in the United Kingdom, one that some watchdogs say is not being taken seriously enough. As a major player in cross-border banking and global finance, the country doesn't just need to combat domestic financial crimes: It's also at risk of becoming a hub for transmitting and investing criminal funds obtained overseas.

While the Financial Action Task Force (FATF), an intergovernmental body that develops policies to combat AML, recognizes the U.K. for its aggressive stance on some types of money laundering, there is limited evidence available on how well the country investigates high-end money laundering — a "long-standing risk area" that watchdog organizations are also pressing with urgency.

The National Crime Agency (NCA) estimates that hundreds of billions of pounds are laundered through U.K. banks and their subsidiaries every year. These illegitimate funds are then used to purchase luxury goods like jewelry, property and art, or pay tuition to elite private schools and universities. Many banks and corporations do not look into the sources of such funding, however, and regulators often do not sufficiently penalize them for turning a blind eye. This does little to discourage the lax behavior, said Susan Hawley, director of policy for anti-corruption nongovernmental organization Corruption Watch UK.

"There's very little enforcement action going on," she explained. "The lack of enforcement action doesn't create incentives for companies and businesses to have in place strong money laundering compliance regimes, [but] that's the kind of stick that gets the industry to get its act together."

Hawley recently spoke with PYMNTS about the U.K.'s troubling state of weak money laundering prosecution and the philosophies that foster it.

REGULATORY WEAKNESS

Among the U.K.'s key AML problems are that current criminal laws can hamper regulators' abilities to respond to problems in a robust manner. U.K. officials are, by law, unable to fine banks or corporations for accepting laundered funds and must go after individuals instead, making it difficult to create long-lasting change.

"One area where the laws are problematic is around big companies," Hawley said. "It is actually impossible in the U.K., under current rules, for big banks to be prosecuted for money laundering."

In addition, many regulators are not keeping up with their responsibilities. An Office for Professional Body Anti-Money Laundering Supervision (OPBAS) report released this week

found that most of the professional lawyer and accountant bodies it oversees do not sufficiently prepare members to fight money laundering or supervise how they should comply with AML laws. Nearly 25 percent of them do not perform any money laundering supervision, according to the study, despite EU requirements that they do so, and 80 percent failed to have the proper governance arrangements in place to combat it in their professions.

"There's a systemic problem within the supervisory regime in the U.K.," Hawley noted. "There isn't enough regulation going on."

Many entities responsible for regulating often have conflicts of interest, too.

"These bodies that regulate are also the trade bodies, effectively, [that] want to lobby on behalf of the business[es]," she added, and key bank regulators are not always properly independent from politicians.

A SLAP ON THE WRIST

Conflicts of interest, legal limitations and their own noncompliance keep regulators from strongly prosecuting money laundering, and penalized corporations often face fines so small when such regulations do get enforced that the amounts seem trivial. Firms that fail to be fully AML-compliant have even avoided being publicly named in many cases, with regulators fining them just £1,000 — which amounts to little more than "a parking penalty," as Hawley put it.

More recent efforts to step up the regulatory game by Her Majesty's Revenue and Customs (HMRC) involved naming noncompliant organizations — a rare move — and involved levying heftier fines, she added. Real estate agency group Countrywide was penalized £215,000 ($283,000 USD) earlier this month for failing to comply with AML regulations, for example, but even that was a fairly low price.

THE ECONOMIC INCENTIVE OF LAX REGULATIONS

One driving force behind halfhearted high-end money laundering investigation efforts is a belief that more robust AML would chill international investment, Hawley explained. The assumption is that it is better to risk accepting criminal funds than deter economic activity.

"While the government might talk big on wanting to tackle money laundering, it also doesn't want to make the U.K. unattractive as a place for foreign investment," she said.

The looming possibility of Brexit means it is possible that regulators will continue to prefer lax regulation implementation if it encourages investment and combats economic damage caused by instability. High-end money laundering is a constant threat in major economic hubs like the U.K., though. Firms should abide by strict AML-compliance regulations to detect and thwart illicit activities, and regulators should wholly investigate suspicious activities to ensure rules are being followed.

The country will need to ensure its AML laws are robust and enforced if it hopes to tackle the high amount of pounds laundered through its banks each year.

UNDER THE HOOD

How will Brexit impact the U.K.'s anti-money laundering efforts?

"We don't know what [Brexit] is going to look like at all. If we're left without a deal, for instance, it would be absolutely catastrophic for the enforcement agencies in terms of their abilities to do investigations, share intelligence and get access to databases. That scenario looks very bad. But, always, even [if Brexit occurs] with a deal, [or] even if the U.K. decides they're not going to go for Brexit after all, the economic damage that's occurred as [a] result of these past two years of debate means the U.K. — particularly under its current political trajectory — is going to want a low-regulation environment, or [at least] that's the risk. They're going to talk tough on crime, but the reality will be a low-regulation environment so as not to discourage investment."

Susan Hawley
director of policy at Corruption Watch UK

NEWS & TRENDS

CRYPTO AML

CYSEC TAPS EU AML CRYPTO RULES

Regulators must stay ahead of the game as payment technologies evolve, ensuring that new solutions don't equate to floods of fraud attempts. The Cyprus Securities and Exchange Commission (CySEC), the country's financial regulatory agency, is currently seeking to better regulate cryptocurrencies and digital assets — and looking to the European Union as a model. CySEC plans to integrate aspects of pan-European AML directive AMLD5 into the nation's laws, enacting registration and due diligence requirements for exchanges and custodian wallet providers that require them to reveal traders' identities and report suspicious activities.

"CySEC has been contacted by entities engaging in crypto asset activities, a number of which do not appear to fall within the existing regulatory framework," the agency noted in a circular. "As a consequence, CySEC considers the transposition of the parts of the AMLD5 concerning crypto asset activities into national law, as appropriate."

The regulator will also apply AML and combating the financing of terrorism (CFT) laws to activities that do not fall under AMLD5. These include crypto asset exchanges, virtual asset transfers and participation in financial services related to an issuer's offer or sale of a crypto asset.

LOCALBITCOINS TO FOLLOW AMLD5

Finnish peer-to-peer (P2P) bitcoin marketplace LocalBitcoins has declared that it, too, will follow the EU's AMLD5, which creates a public company/owner database and extends the EU's AML regulations to cryptocurrencies. Although EU member states do not need to comply with the directive until January 2020, the exchange was spurred to act early to comply with changes in its home country. Finland has chosen to move faster, already drafting new legislation regarding virtual currency services.

LocalBitcoins' compliance means that account registration, identity verification and wallet withdrawal tiers will all undergo changes, which the company asserts will improve platform safety and enable it to more proactively combat fraud.

CHAINALYSIS OFFERS STABLECOIN AML SOLUTION

Other crypto players are also looking to increase their vigilance. Cryptocurrency compliance and investigations solutions provider Chainalysis recently announced a new solution aimed at stablecoins. The real-time AML know your transaction (KYT) product monitors stablecoins across transactions from issuance to redemption. The company asserts that it is the first solution of its kind for stablecoins, and issuers can integrate KYT through an API to monitor transactions and evaluate holders' risk profiles.

"Chainalysis exists to build trust in cryptocurrencies among institutions and users," said Jonathan Levin, Chainalysis' chief operating officer. "The repeated knock against cryptocurrency is its volatility, and trust in stablecoins could lead the way to increased commercial use."

REVIEWING REGULATIONS

FINTRAC COMPLETES PENALTY SYSTEM REVIEW

Canada has also been taking a fresh look at compliance approaches. AML agency FINTRAC recently completed a nearly three-year internal review of its penalty system, a process prompted by a 2016 Federal Court of Appeals ruling that its monetary fine calculation methods lacked transparency. FINTRAC can issue hefty noncompliance fines, including penalizing firms as much as $1 million for failing to report suspicious transactions. The company ceased issuing such fines following the court ruling, instead using other enforcement tools while it reviewed its policies. It recently released a revision regarding how it calculates fines, and will once again begin issuing penalties.

FATF PRAISES UK AML, CTF MEASURES

While FINTRAC puts its AML policies back on track, the U.K. has reason to believe its own are running smooth. The Financial Action Task Force (FATF), which evaluates AML and counter terrorist financing (CTF) measures employed by 36 counties, has recognized the U.K. for its work, claiming the country has "routinely and aggressively" investigated and prosecuted money laundering and terrorist financing activities.

Watchdog organizations like Corruption Watch, Global Witness and Transparency International UK objected to the sunny assessment, however. The trio issued a joint statement noting that the National Crime Agency (NCA) estimates the U.K. experiences hundreds of billions of pounds worth of money laundering each year.

FENERGO LAUNCHES SAAS REGULATORY COMPLIANCE OFFERING

Client lifestyle management (CLM) software provider Fenergo recently announced a new cloud-based regulatory rules offering. The API-enabled, software-as-a-solution (SaaS) subscription product is geared toward FIs in various markets, providing an on-demand repository of local and global KYC and AML rules as well as other regulatory requirements. It

is hosted on Amazon Web Services and designed for easy integration into FIs' digital platforms to help them remain compliant as regulations change. Fenergo's partnerships with client relationship management providers bring additional services to the subscription offering.

"Banks and financial institutions are undergoing a major shift, where the experiences their customers receive now takes precedence," said Greg Watson, Fenergo's global head of sales. "Simultaneously, we're seeing increasing demand for an out-of-the-box rules engine that would complement existing CLM infrastructures. Fenergo's externally validated Rules as a Service supports financial services providers in complying with regulatory obligations while liberating them to focus on the delivery of optimum customer experiences."

SECURITY IN ASIA

TRUILOO EXPANDS GLOBALGATEWAY

Global companies are turning fresh eyes to Bangladesh, an emerging market that is seeing increased demand for digital services. Financial companies must be able to administer KYC and AML checks — and complete other compliance, risk mitigation and fraud prevention requirements — before they can extend such services to consumers, however. To facilitate this phase, global identity and business verification firm Trulioo recently announced that its GlobalGateway solution for digitized, automated due diligence processes will now also cover Bangladeshi consumers.

"Economists, investors and global businesses have taken notice of the country's economic turnaround," said Stephen Ufford, CEO and founder of Trulioo. "The majority of the adult population in Bangladesh owns mobile phones, which is driving the demand for digital services."

This isn't the only new country covered by Trulioo, either. It also extended global identity verification support to the Czech Republic, Poland and Slovakia in the past two months.

RBI REGULATIONS TO IMPACT AMAZON PAY KYC

Mobile wallets are facing new verification rules abroad. New Reserve Bank of India (RBI) regulations came into effect this month, requiring mobile wallets to undergo full KYC

processes rather than the partial ones previously carried out. This affects Amazon Pay, FreeCharge, MobiKwik, Paytm and other mobile wallets, whose operators can now allow users to submit identifying documents online and authenticate themselves with one-time passwords sent to their mobile numbers. Under the full KYC requirements, operators must physically verify mobile wallet users' identification documents. Customers will not be able to load money onto their wallets unless they pass this full KYC process, which must be completed within one year after signing up with a service.

Amazon made moves in February to provide its Amazon Pay UPI service to Android users in advance of the regulations' implementation. This could help Amazon bypass the regulation, as it enables eCommerce shoppers to pay via India's UPI, which transfers funds directly between bank accounts.

KYC IN PORTUGAL AND PANAMA

BANCO CTT SELECTS FISERV FOR AML

FIs worldwide are beefing up their AML defenses, and Portugal's Banco CTT has selected a Fiserv solution to help grow its customer base. The AML Risk Manager platform utilizes behavioral profiling, inference techniques and visualization tools to monitor transactions and provide customer risk profiling and KYC. Banco CTT was reportedly also looking to minimize instances of legitimate transactions being investigated, a process that could cause friction for customers.

Founded in 2016, Banco CTT currently operates 212 branches and has seen its base grow from the 100,000 customers it counted nine months after its launch to 390,000.

PANAMA CREDIT BUREAU TAPS FICO

In other AML and KYC news, Panama credit bureau APC Intelidat announced plans to use a FICO financial crime

compliance solution. Its customers will be able to access the TONBELLER Siron KYC module through APC's infrastructure to assist with due diligence processes and local law and regulation compliance. FICO's solution monitors changes within existing customer bases, updates customer risk profiles and supports due diligences processes for high-risk customers. Its integration with APC's platforms is ongoing and it is set to release to clients in a few months.

AML CRACKDOWN

EU EXPANDS AML, CTF BLACKLIST TO 23 JURISDICTIONS

Not everyone keeps their due diligence measures up to snuff, however. Nigeria, Panama, Saudi Arabia and the U.S. Virgin Islands, among others, have all failed to sufficiently protect against money laundering and terrorism financing, according to the European Commission. As such, it has moved to add these jurisdictions to its AML/CTF blacklist, bringing the total count to 23 regions. Entities such as banks, which are covered by EU AML rules, will be required to enhance their checks on operations that involve FIs and customers from the prohibited countries, including Afghanistan, American Samoa, the Bahamas, Botswana, Ethiopia, Ghana, Guam, Iran, Iraq, Libya, Nigeria, North Korea, Pakistan, Panama, Puerto Rico, Samoa, Saudi Arabia, Sri Lanka, Syria, Trinidad and Tobago, Tunisia, the U.S. Virgin Islands and Yemen.

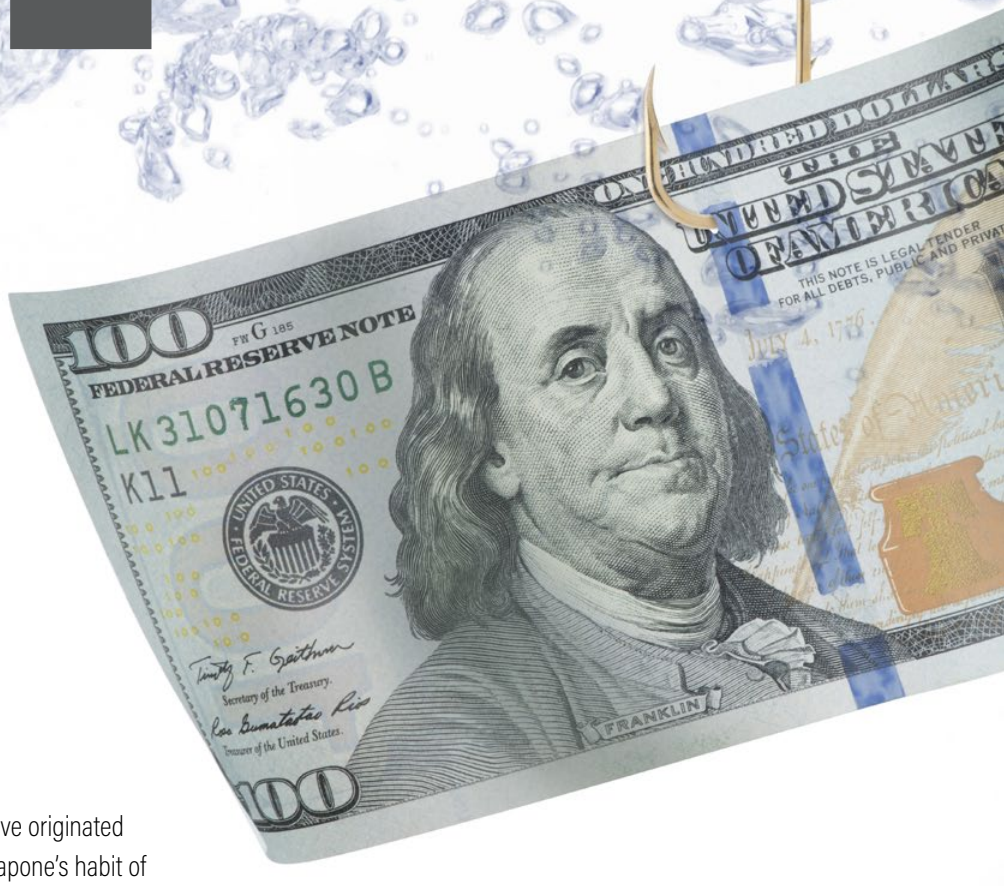
RBI FINES BANKS FOR NONCOMPLIANCE

The RBI is cracking down on misbehavior, too, targeting seven banks following assessments of fraud direction noncompliance. Allahabad Bank, Andhra Bank, Bank of Maharashtra and Indian Overseas Bank were fined for lax monitoring of funds' end uses, information exchanged between banks, fraud classifications, fraud reporting and account restructuring. Meanwhile, HDFC Bank, IDBI Bank and Kotak Mahindra Bank were docked for noncompliance with RBI's KYC and AML standards.

"This action is based on deficiencies in regulatory compliance and is not intended to pronounce upon the validity of any transaction or agreement entered into by the banks with their customers," RBI said in a statement.

DEEP DIVE

AN AUTOMATED APPROACH TO THE $2T GLOBAL MONEY LAUNDERING PROBLEM



The term "money laundering" is believed to have originated as a result of infamous Chicago gangster Al Capone's habit of channeling criminally obtained funds through laundromats, as their cash-heavy nature made it more difficult for the right side of the law to detect such money mixed in among legitimate payments. Money laundering has evolved greatly since Capone's activities in the early 1900s, though, and it is becoming harder to combat. As such, the regulators and FIs seeking to crack down on these activities have their work cut out for them.

Approximately 2 percent to 5 percent of the world's gross domestic product (GDP) — $800 billion to $2 trillion — is laundered each year, according to a United Nations Office on Drugs and Crime (UNODC) report. Digitalization, fast-moving payments, international trade, global economic interconnections and a lack of standard regulations across markets all make money laundering and CTF immense challenges for FIs — something firms are working hard to address.

RETHINKING SECURITY STRATEGIES

Money is the lifeblood that fuels any organization, and that includes terrorist and other criminal groups. FIs that fail to catch illicit activities miss opportunities to hamstring such operations and unwittingly help fund them. They can also find themselves facing significant fines if they fail to sufficiently adhere to rules designed to catch money

laundering: Worldwide, banks paid out approximately $321 billion between 2009 and 2016, for example, because they failed to comply with money laundering, terrorist financing and other regulations.

FINANCIAL AND ETHICAL SECURITY STRATEGIES

Faced with these dual motivations, banks around the world are investing in regulatory compliance and were projected to spend more than $8 billion on AML compliance by 2017. They need to be certain that their compliance dollars are making a tangible difference in their AML and CTF successes, however, and must keep up as regulations change and governments level economic sanctions against other countries. In addition, FIs must also keep pace with fast-moving international money flows as they monitor transactions.

Many have already begun hiring more investigators and other relevant staff in response, with some major U.S. banks increasing their AML compliance staffing tenfold between 2012 and 2017, according to one report. This approach can be costly, however, and doesn't always have enough impact if new employees aren't simultaneously supported by efficient procedures and technology. In too many cases, FIs create separate compliance programs based on specific countries, products and customer bases, which can be inefficient and expensive and FIs' efforts may suffer from manual, siloed and inconsistent processes.

TURNING TO AUTOMATION TECH

Against this backdrop, attention has turned to the support offered by automation tools like AI, which can free up staff to focus on higher-risk cases. These solutions are tapped to reduce human error, perform data analysis, identify connections, provide a more holistic view of potential money laundering and speed up decision-making

processes. AI could be particularly meaningful in analyzing customer behavior for suspicious activities, accelerating customer validation, automating suspicious activity report filing and mapping interconnections between clients, among other areas.

Expectations have been high so far. One report estimates that AI applied to KYC and AML, authentication, compliance and data processing in the global banking industry could reduce costs by 47 percent. Other researchers claim that, in some cases, allowing machine learning algorithms to analyze transactions has led to a 20 percent to 30 percent reduction in false money laundering reports.

With money laundering being a global financial problem, FIs need to equip themselves with as many tools as they can. They're facing hefty fines for insufficient adherence and wrestling challenges related to evolving financial and regulatory ecosystems, after all, meaning they need to be sure their AML and compliance budgets are invested where they'll have the greatest impact. Reports suggest automation and AI could become increasingly important for compliance-conscious FIs.

about

PYMNTS.com

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Trulioo

Trulioo, an identity verification solutions provider, aims to create products that can solve online identity verification challenges in ways that are accessible to both SMBs and large enterprise customers. The company offers a single portal/API that assists businesses with their AML/KYC identity verification requirements by providing secure access to more than 5 billion identities worldwide.

We are interested in your feedback on this report. If you have questions or comments, or if you would like to subscribe to this report, please email us at stateofAML@pymnts.com

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