Know Your Customer (KYC)

Trusting someone you have never seen

PENNEO

About Penneo

Penneo was founded in 2014 with the ambition of reducing the hassle of getting documents signed by delivering a digital signature platform. Since then, Penneo has evolved into a set of solutions for automating workflows related to client onboarding (KYC), signing, and document management. Its powerful solutions help organizations in regulated industries to meet compliance requirements in an efficient and secure way. With Penneo, companies reduce time spent on administrative tasks and operational costs, while improving productivity and the end-user experience.

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Introduction: Looking backwards to move forward

In the past, it wasn't that difficult to get to know your customers. High-value business transactions did not require particular identification procedures to take place. Most businesses were local businesses, you probably already knew your client even before they became such – or if you didn't, someone you knew likely knew them. In today's global, internet-based economy, though, the game has changed.

With the introduction of KYC duties and AML regulations, conducting due diligence on your clients is not just a smart move – it's a required one.

Companies are now under growing pressure to verify the identity of their clients along with their potential risk factors or illegal intentions.

Customer due diligence is now an ongoing activity that all companies must plan for and stay on top of.

However, most companies don't have the necessary know-how in-house to carry out this task by themselves. Besides, things get even more complicated in an age where organizations rarely interact with their customers face-to-face.

Digitization has made the world a single interconnected marketplace, crossing the traditional language and distance boundaries between businesses and consumers. While this created unprecedented economic opportunities, the risks and complexity of cross-border relationships have also significantly increased. There is no guarantee that the person who approaches your business is who they say they are – nor could you know what they might be involved with.

Collecting high-quality KYC information has historically been a tedious, difficult, and unreliable task.

How the way we conceived identity has changed

Online operations and transnational relationships are now the basis of daily business. But despite this now established confidence, we can still see the reversion to paperwork and offline processes when it comes to identification – especially when more valuable or trust-based transactions are involved.

That's because people are traditionally used to dealing with paper documents and the lack of familiarity with new types of electronic methods leads them to fear that risks might be higher.

It is a transition process between analogue and digital that has crossed all sectors. Just as the way of looking at international trade and money transfers has changed, in the same way we'll witness the rise of a new concept of identity. In fact, many similarities can be found between the current perception of digital identification and the situation of cross-border payments in Europe only ten years ago.
Transfers between European countries were considered international and could take days; it was thanks to the creation of the single European payment area (with the SEPA project) that cross-border electronic
payments have become as easy as domestic payments. The same is now happening for **digital identities**.

We will soon find ourselves using exclusively digital IDs and wonder why we ever put so much trust in paper-based administration.

Upgrading the onboarding processes

If digitization is the starting point for any business improvement, automation is necessarily the next step. And this is particularly true for KYC procedures.
Implementing new technology solutions improves the onboarding operations from at least three perspectives: speed, security and efficiency. A faster, easier and more user-friendly process benefits both the company and its clients as it drastically reduces the amount of time and effort required to perform customer due diligence. Just as important is increasing the reliability and quality of the results while documenting that regulatory obligations have been met. Strengthening the client onboarding process will allow companies to modernize their routines while raising the bar for fraud and money laundering risk management. You will not only be protecting yourself but anyone who might otherwise be harmed by financial crime.

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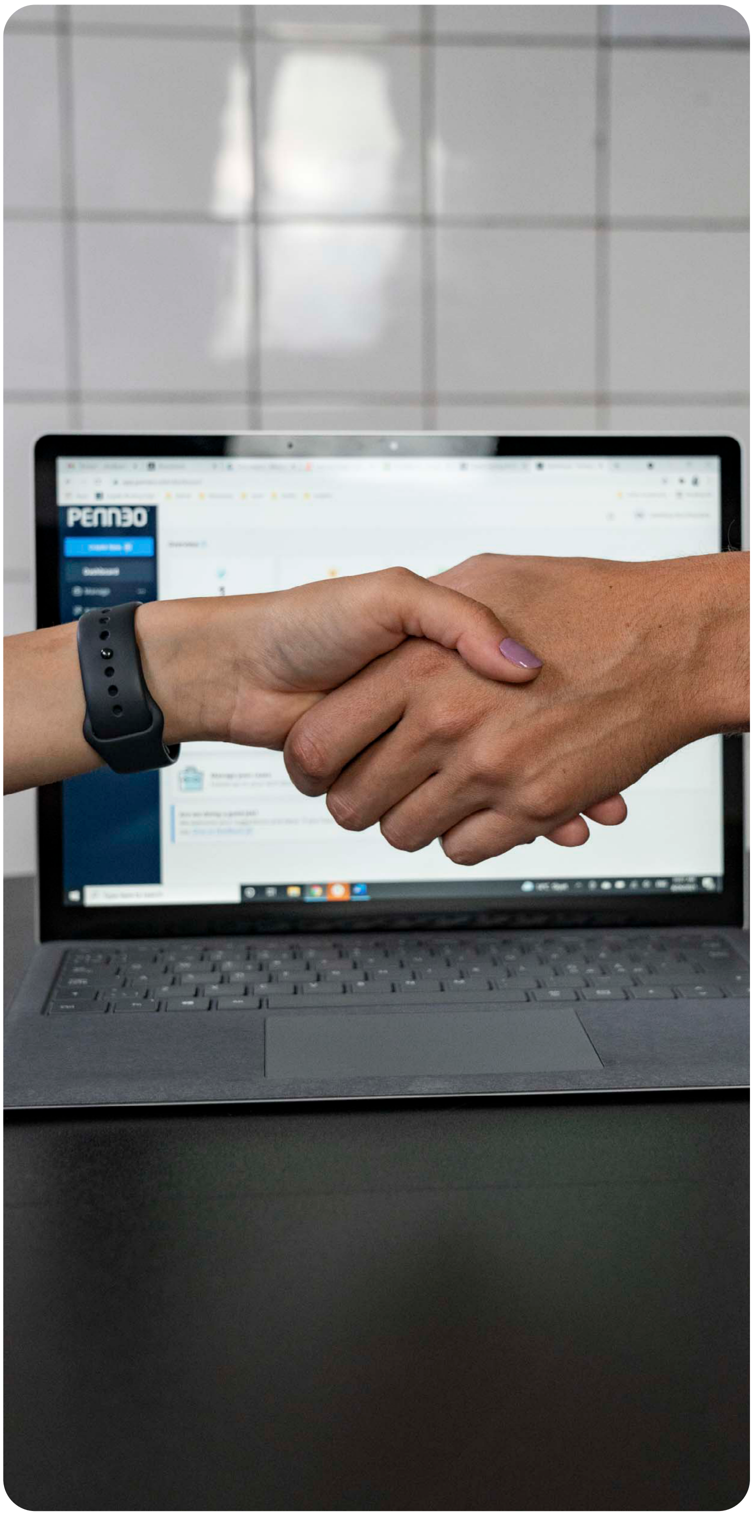
Part 1

KYC insights

Know-Your-Customer: legal obligation or business need?

What exactly is meant by “knowing your customers”?

KYC means ensuring a potential customer is trustworthy in the sense that they can prove their identity and the legality of their business. This secure identification is equally needed during client or corporate onboarding, user registration, in case of processing of high-profile transactions, in order to re-verify existing users and ensuring regulatory compliance.



Is it required by law for all companies?

KYC rules are dictated by AML regulations, therefore their application is mandatory for the "obliged entities" these laws apply to, which include:

- Financial services institutions, i.e. credit institutions, banks, insurance companies, investment firms
- Auditors, external accountants, and tax advisers
- Independent legal professionals who participate in any financial or real estate transaction
- Trust or company service providers
- Estate agents
- Gambling services providers
- Other persons trading in goods over € 10.000

Although this list already includes most of the businesses, today not only the formally obliged organizations put in place a KYC policy framework. Any company needs to make sure a potential client is law-abiding and truthful.

Even for industries that were not traditionally obliged, KYC compliance is rapidly becoming the norm on the international business stage.

Consequently, more and more businesses of all sizes are implementing processes for assessing the suitability of their clients and ensuring they are anti-bribery and AML compliant.

Customer due diligence (CDD) stands out as a critical element in the Risk Management System.

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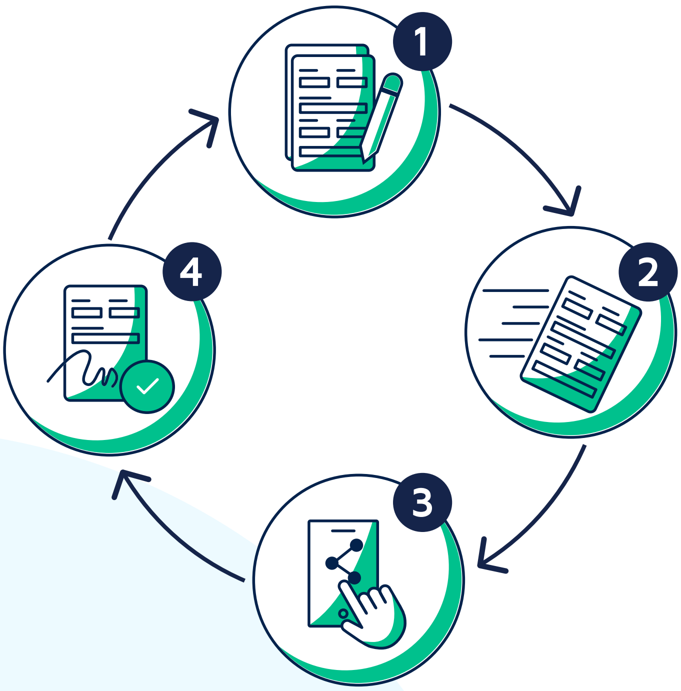
Even if your business does not seem to fall into any of these categories, the implementation of security procedures in the client onboarding process is always highly recommended.

Getting started

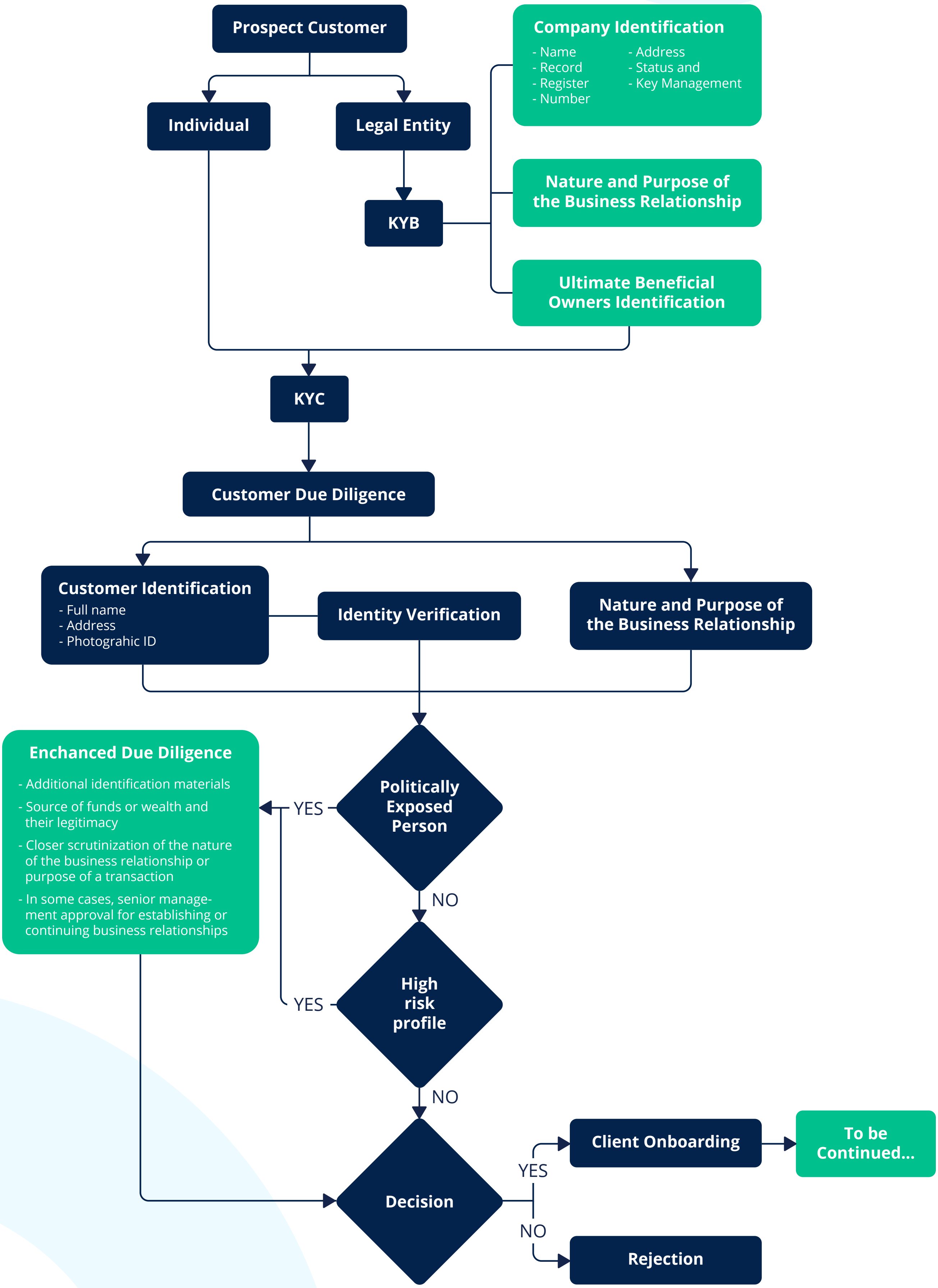
- **Know Your Customer (KYC)** refers to the steps taken by a company in order to perform identity checks on clients.

- **Know your Business (KYB)** concerns the same process when this applies to businesses, instead of individual consumers (also known as [Corporate KYC]). Companies that offer their services to other companies (B2B) have to ensure that they are doing business legally and with legitimate entities. To this end, they need to verify the identity of the real person they are doing business with, that is natural person who ultimately owns or controls the legal entity customer on whose behalf a transaction is being conducted.



- **Customer Due Diligence (CDD)** is the process of background checks run in relation to the level of risk presented by the customer. It involves:
  - Client Identification
  - Beneficial Ownership: identification of the natural person(s) to whom a business is registered, as well as the acting chief executive and directors, and anyone else who has a stake of 25% or more in the company, known as Ultimate Beneficial Owners (UBOs); this determination is necessary to be able to perform then KYC checks on all individuals identified as UBOs
  - Business Relationship: information on the nature of the business relationship they are entering and its purpose.

- **Enhanced Due Diligence (EDD)** is a more complex procedure that takes place where the customer has a higher risk profile. In such situations, organizations must therefore put in place extra measures, such as obtaining additional identification materials and implementing monitoring procedures to assess ML/TF risks. Although the identity of all customers must be established, in some situations particularly rigorous CDD is required. It's the case, for example, of **Politically Exposed Person (PEP),** meaning a person who is or has been entrusted with prominent public functions (and their family members, the so-called RCA – Relatives and Close Associates).
- **Know Your Customer's Customer (KYCC)** is the process that detects the identity and assess the risk level of a client's client. This derivative of the standard KYC process was built to deal with the growing cases of financial crime resulting from fraudulent individual or companies that might otherwise be hiding in second-tier business relationships.


Prospect Customer
Individual
Legal Entity
KYB
Company Identification
- Name
- Record
- Register
- Number
- Address
- Status and
- Key Management
Nature and Purpose of the Business Relationship
Ultimate Beneficial Owners Identification
KYC
Customer Due Diligence
Customer Identification
- Full name
- Address
- Photograhic ID
Identity Verification
Nature and Purpose of the Business Relationship
Enchanced Due Diligence
- Additional identification materials
- Source of funds or wealth and their legitimacy
- Closer scrutinization of the nature of the business relationship or purpose of a transaction
- In some cases, senior manage-ment approval for establishing or continuing business relationships
YES
Politically Exposed Person
NO
YES
High risk profile
NO
Decision
YES
NO
Client Onboarding
To be Continued...
Rejection

- What are **the best KYC practices** according to regulators?
- What **requirements do you need** to comply with?

The European regulatory landscape has changed over the past few years. Two main factors led to legislative news:

- On one side, the increasing frequency and severity of issues pertaining to [corruption, terrorist financing and money laundering] has made more and more evident and urgent the need of proper KYC policies;
- On the other, electronic identification methods have been identified as an effective solution to meet current security needs: [e-identity schemes] are not only essential in the modern client-business relationship lifecycle, they are also the key to trustworthy cross-border mutual recognition of electronic interactions.

Know-your-customer processes have thus been evolving and expanding globally.

Legislation is not only a good starting point, but a necessary framework to build on and a key condition for success.

What **rules** do they **lay down?**

- **Financial Action Task Force** (FATF) Recommendations measures recognized as the global AML and CFT standard
  - Legal entities should conduct ID verification of clients by requesting and verifying their "Proof of Identity (photograph of an official document such as a passport)
  - Simplified CDD measures and electronic identity verification can be used whereas suitably mitigating the ML/TF risks.
- **Markets in Financial Instruments Directive** (MiFID II, EU Directive 2014/65)
  - Financial institutions must require a much larger amount of KYC information during customer onboarding and deeply check clients' suitability and asset management.
  - The greater amount of data collected should be processed using new technology solutions that enable a more transparent and successful protection of PII involved.
- **4th Anti Money Laundering Directive** (4AMLD, EU Directive 2015/849)
  - Institution of a central registry for beneficial owners.
  - Enforcement of a risk based approach with different rules and procedures for low and high risk customers (i.e. simplified and enhanced due diligence frameworks).
  - Businesses are allowed (and encouraged) to employ electronic identity verification or e KYC to identify customers remotely.
- Financial Crimes Enforcement Network (FinCEN) **"Customer Due Diligence Requirements for Financial Institutions"** (the CDD Rule)
  - The definition of the Ultimate Beneficial Owner is introduced, along with the requirement of verifying their identity. Subsequently, PSD 2, AML Directives, and the GDPR required companies to verify UBOs' identities.

Which major **Anti-ML/TF laws** have been enforced so far?

2012

Feb 2012

FATF Recommendations first version was adopted

2013

2014

June 2014

MiFID II was adopted

2015

June 2015

4th AMLD was published

2016

July 2016

2017

FinCED CDD was published

July 2019

FATF last update

2019

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Which major Anti-ML/TF laws have been enforced so far?

What rules do they lay down?

Feb 2013

FATF Guidance on AML first version was adopted

July 2014

eIDAS was adopted

January 2016

PSD2 was published

Payments Services Directive

(PSD2, EU Directive 2015/2366)

- Payment transactions processed within the EU require the customer's identity to be verified using a two factors authentication the so called Strong Customer Authentication (SCA) - with clear implications for the KYC process and its digitalization.

2018

June 2018

5th AMLD was published

5th Anti Money Laundering Directive

(5AMLD, EU Directive 2018/843)

- Extension of the scope of the 4th AML
- Explicit promotion of the use of electronic signature and digital identification means as standardized by the eIDAS Regulation 910/2014 to carry out the verification of the customer's identity.

May 2018

GDPR entered into force

General Data Protection Regulation

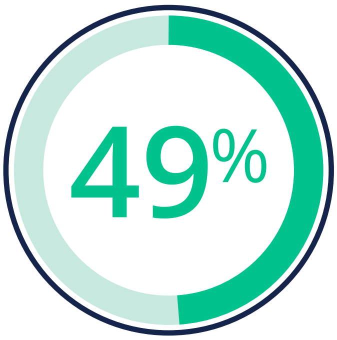
(GDPR, EU Regulation 2016/679)

- The company needs to map in detail what KYC data was collected (where, when, and why) and be able to retrieve, share, or erase all the information it holds on a specific user might the need the arise.

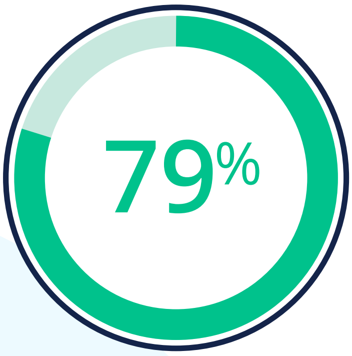
Part 2

Evolving KYC operations

of global financial and AML professionals named compliance as a major challenge.



of organizations globally said they've been a victim of fraud and economic crime[2]



see automating data and workflow to save time and cost as a priority[1]

€48million

is the average annual spending for financial institutions' KYC processes[3]

Current status of affairs

Complying with the KYC rules is widely considered a major challenge for a business, as well as an expensive and time-consuming journey.

The obstacles on the way, however, cannot justify any delay or inaccuracy in abiding by relevant legislation. As the scale and impact of financial crimes have grown significantly, fighting fraud is today a core business issue. What's more, the economic losses due to said fraud would add to the already hefty expenses that a company has to bear to conduct the customer onboarding process.

Not to mention the reputational damages and the harmful impact on business relations, which place a costly burden on themselves.

If it is true that almost half of the global organizations are experiencing economic crimes, it is natural to wonder what the situation is for the remaining 50%.

Have they avoided falling victim or simply don't know about it?

Another aspect to consider is that not all companies are fully aware of the risks they face. They often don't even know what fraud looks like or how to detect financial crime threats.

Knowing the unknowns

There is no other way to find effective solutions than starting by asking the right questions:

- **How well do I understand my risks?**
- **How can I allocate my resources more effectively?**
- **Am I taking the right steps to protect my business?**

The main problems found along this path concern the legality and safety of the procedures implemented. Besides, equally relevant are the problems due to inefficient business operations and their implications on the customer experience.

It's time for all businesses to shed light on blind spots and improve their KYC efforts.

What are the main challenges that companies face with KYC oprations

Most companies still rely on "old school" KYC processes based on scanned copies of passports or similar IDs requiring the customer to be physically present to share such sensitive information via email.

This complex manual routine that captures data through emails and papers results in a cumbersome and insecure process with more human efforts and errors.

And for smaller companies the costly burden is even greater and disproportionately heavy. This has negative effects both on customers and on the company in terms of troubles in being compliant and wasting time and resources.

In the digital age, the consumers themselves have experienced an evolution of their expectations, hand in hand with technological development.

The modern customer requires the remote availability of the services they need, anywhere and anytime at the click of a button.

And this demand of user-friendliness and speed can only be addressed with a flexible and dynamic approach. Along with these needs, it also arises the concern over the sensitive information to be provided and its processing.

The huge amount of personal data requested from customers can seem intrusive and burdensome, raising doubts about the very relevance of the collection. But it is the regulations that today require companies to ask for a lot more KYC information during customer onboarding.

The collection of a more significant amount of personal information translates into much more data to process and be responsible for.

Further problems spring up in this area since the data collected is not always tracked. Retention and deletion policies are often not up to date. The protection offered by the security management to clients' PII is sometimes inadequate. These issues have foreseeable consequences on the company's ability to collect the due KYC information while complying with the law requirements.

To sum up, the issues linked to ineffective KYC operations arise from three perspectives:

Business management

- **Process inefficiencies:**
Labour-intensive manual activities cause duplication of effort and risk of errors, resulting in redundant operations that increase rework and lessen staff productivity.

- **Minimal technology investments:**
Growing transaction volumes require continuous investments in technical capabilities (e.g. case management, client portal).[4]

Customer experience

- **Inadequate onboarding:**
Disjointed processes and periodic refresh systems result in frustrating experience for clients, subject to long processing times and repetitive questioning.

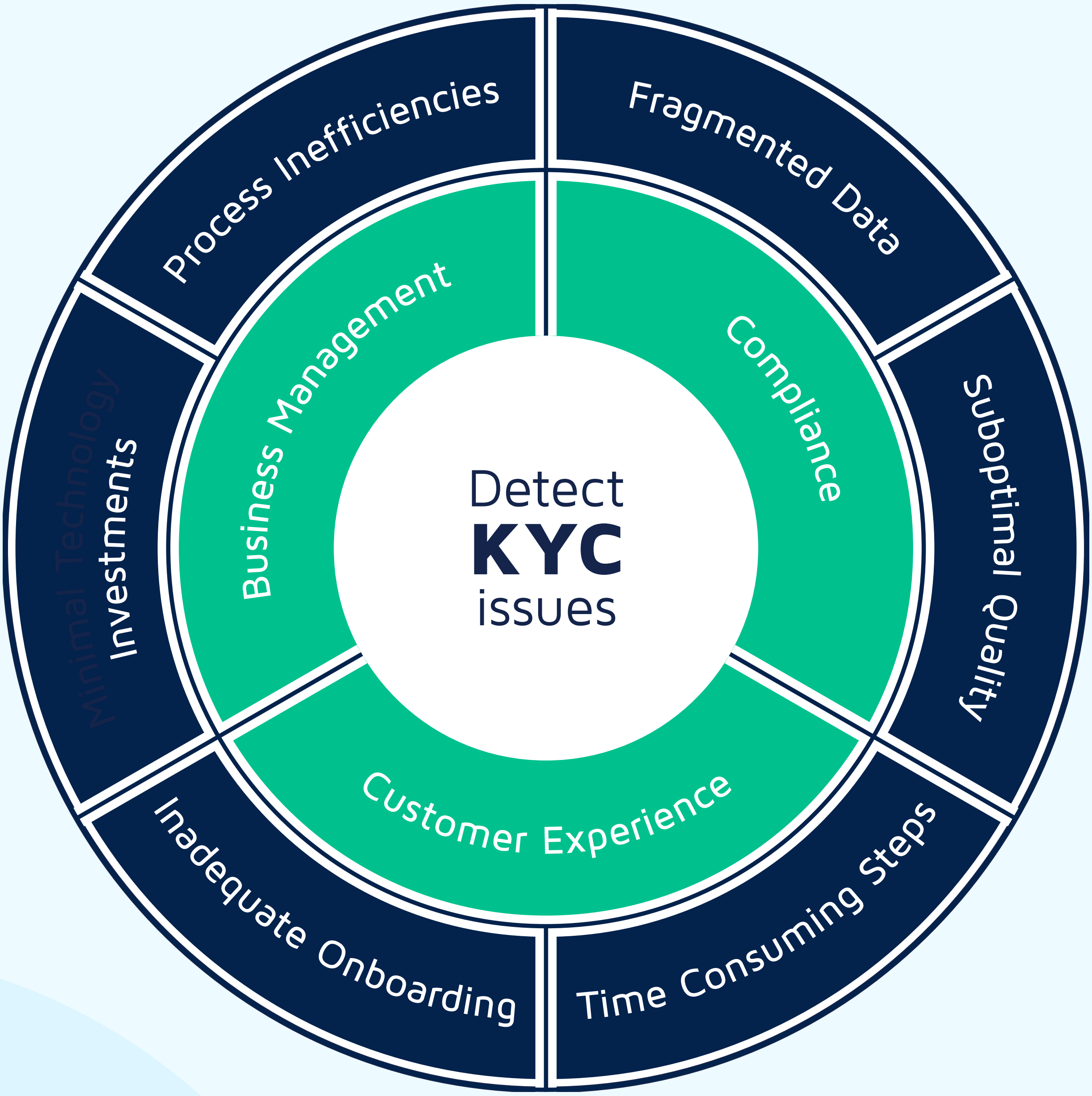
- **Time-consuming steps:**
Customers' expectations nowadays demand easy and immediate access to services and certainly no longer include physically coming into a branch.[5]

Compliance

- **Suboptimal quality:**
Non-standardized processes with limited automation and poor controls result in variable strength of the KYC documentation obtained.

- **Fragmented data:**
Siloed, duplicative, and inconsistent information, along with operational inefficiencies, limit the ability to meet legal requirements.

Evolving KYC operations



What improvements are needed?

For any company dealing with KYC, being compliant is a major issue. Still, it's a far bigger challenge achieving it in a cost-effective and scalable manner while preserving the best possible customer experience.

Error minimization and process speed up can be pursued with the same solution: digitization and automation of client onboarding.

The first step to enhancing operations efficiency is replacing manual methods and multiple and disconnected systems with innovative and harmonized solutions. New technologies improve synergies, streamline the workflow, and reduce costs. But that's not all. Digitizing brings further benefits that extend beyond the business management area.

It's a company-wide change, crucial to meet clients' needs and provide a better and seamless experience.

Frustrating delays and disappointment for the KYC procedures can damage customer relationships or even cause a company to lose a client, with a negative impact on both the revenue and the brand. This is where the importance of a fully digital and streamlined process lies: in emphasizing consumers' expectations by ensuring a smoother, internet-only and more convenient experience.

A user-friendly KYC hits the target by simplifying the clients onboarding while building customers' trust.

But to obtain lasting confidence and customer loyalty, a company also needs to demonstrate its commitment to security and data protection. This is why compliance can ultimately be seen as a business advantage, as it turns from a legal obligation to a competitive differentiator. Knowing what data is collected, where it is stored, and who has access to it is the basis of any company's security policy. This awareness is also the necessary starting point to prove the fulfillment of KYC duties and be able to analyze, track, and monitor the information gathered.
Moreover, it is crucial to avoid duplication and confusion when it comes to data sharing or erasure requests.

Businesses operate today in a fast-growing highly-regulated environment whose rules are strictly enforced. The traditional old-fashioned onboarding process does not address the modern needs and certainly doesn't meet the legal demands.

Therefore, the obligatory path appears to be, embracing a digital solution that enables to maintain regulatory compliance and, at the same time, sharpens the entire security system.

The aforementioned challenges can, in turn, be tackled through a threefold approach:

Business operations optimization

- Define business rules to reduce inefficiencies and decrease the total cost of AML compliance.
- Invest in technology solutions to limit manual tasks and automate the processing of KYC cases.

Greater transparency in data collection

- Reduce onboarding time and enhance customer experience through digitization.
- Know your customer better through streamlined processes and relevant data collection.

Risk management improvements

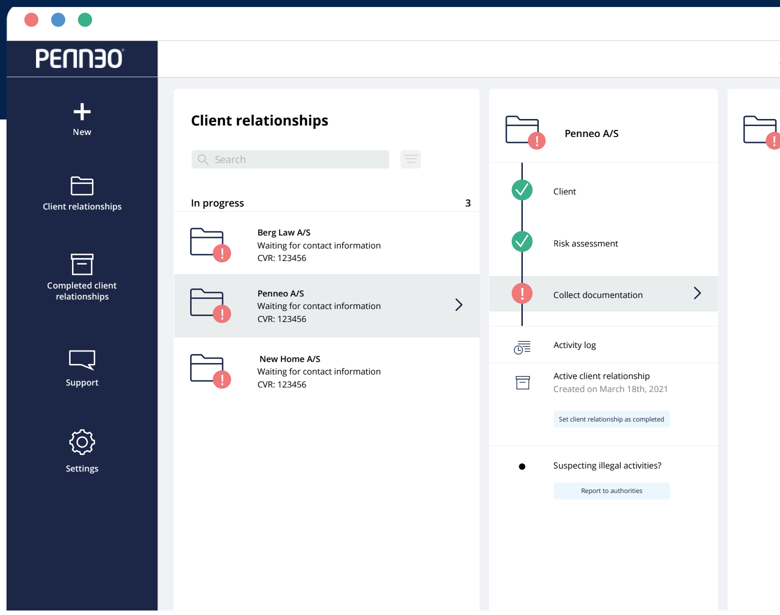
- Define policies aligned with regulations and ensure their appropriate execution throughout the organization.
- Implement security measures for sharing and storing KYC information in a safer manner.[6]

Before

After

Part 3

The way ahead: the future of onboarding



Reimagine KYC operations

The following market trends are pushing companies to progress in the client onboarding process:

- More pressing regulatory intrusiveness
- Changes in consumers' expectations
- The explosive rise of data
- Successful steps of artificial intelligence (AI)
- Growing risks of financial crimes
- Increasing seriousness of their damages

No company can afford to turn a blind eye to these obvious signs.

Today's business world demands more flexible and responsive solutions in order to stay competitive and relevant in a fast-paced marketplace.

The technological advancement gains more speed year after year, increasing the demand of expeditiousness and global availability. Investing in digital solutions lets a business take advantage of those transformations and brings unprecedented convenienceand capability to keep up with the evolving commerce and save time and resources.

Adapting to the new environment is the only way to avoid the risk of being left behind in a society moving towards digital technology.

Customer Due Diligence process is a key functional area that should be part of the overall innovation roadmap for every business.

The transition always takes time and effort, but that should not be used as an argument for further postponing the due migration to digital. To strengthen organizations, business processes should be shaped from the very beginning to be cost-effective and fully compliant.

Quick tips

1. Develop compliance awareness

An ethical organizational culture is vital to build deeper responsibility and involvement across the whole organization and improve the security profile of your enterprise.

2. Keep yourself up to date

As the legislative scenario is constantly changing, you need to regularly monitor the enforcement of new rules and requirements to demonstrate agility and foresight in promptly adjusting your policies.

3. Know your customer

Implement a comprehensive KYC framework that includes detailed procedures for customer identification and verification, risk assessment and enhanced due diligence, as well as ongoing monitoring and reporting.

Is your business on the right track?

What stages should be included in your KYC process?

1. Data Collection & CDD

The customer identification program starts with the gathering of clients' personal information. The identity and location of the person and their business activities must be assessed by relying on official documents. In case of KYB, a detailed company record - including register number, company name, address, status, and key management personnel - must be collected to understand the ownership's structure and identify UBOs.

2. Risk Assessment & EDD

Individual customers and UBO's IDs must be verified against trusted sources such as AML watch lists and EU sanctions lists. The procedure also aims to ascertain if a client is a PEP (or an RCA). After that, a risk rating is applied. If it turns out that the customer has a high-risk profile, an EDD is carried out. At the end of this procedure, it is decided whether to approve and onboard the client or reject their application.

3. Continuous Monitoring

The risk assessment should be periodically reviewed and updated. AML laws require organizations to verify their customers' identities and transactions not only during clients' onboarding but for the whole duration of the business relationship. Therefore, regular checks on existing clients' status need to be performed to flag any changes in their situation and risk profile.

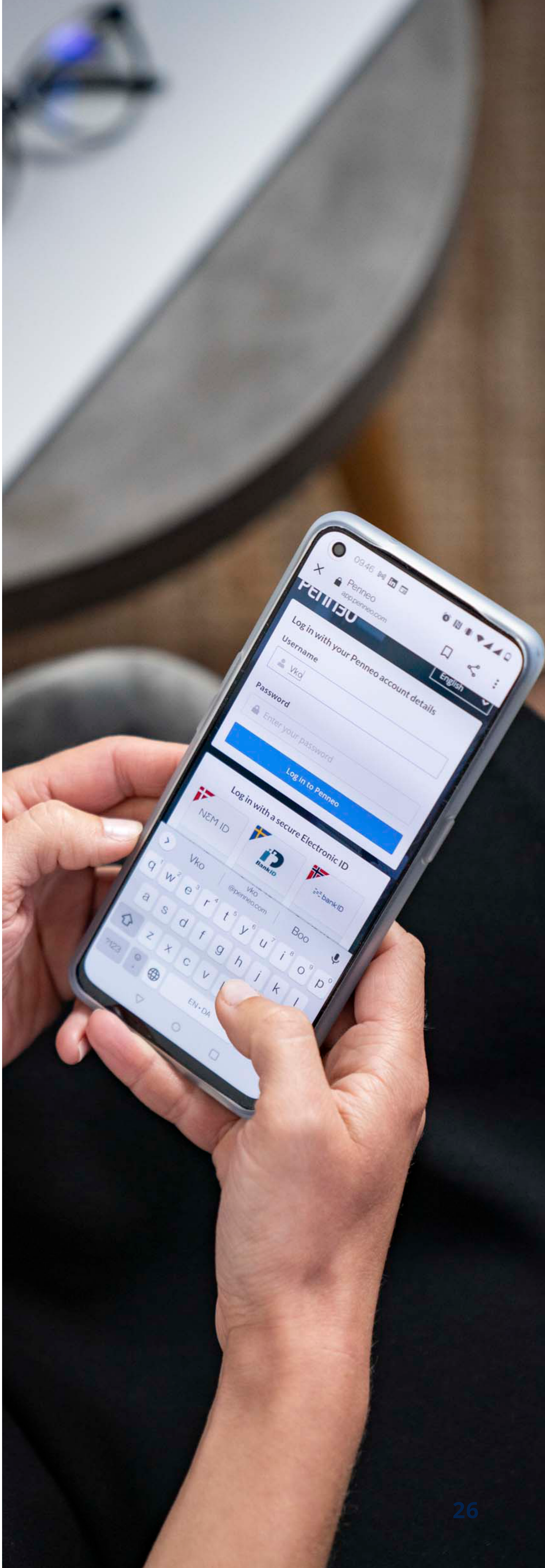
4. Analysis & Reporting

The data obtained should be exportable in an auditable KYC report in PDF format. After that, the findings must be subject to ongoing study and tracking to oversee financial transactions and verify cross-border activities. This continuous analysis aims to allow the immediate reporting of suspicious activities, both internally within the company and externally, to relevant authorities.

What should you look for in a KYC product?

All organizations need to balance where they are with where they are going. Your current operating model probably looks pretty stale, even if it has served you quite well so far. Small and large changes around industries and customers ask for an overall shift in the IT model. The transition is now more than ever expected to address business issues and help the entire organization achieve its goals – creating new markets, reshaping the brand, and outperforming competitors. This is why embarking early on the digitization of onboarding processes must be prioritized in the business strategy.

Although each company has its own nuances, the best suited solution for all of them will be an e-KYC product because of the countless advantages it involves.



Digitization and automation effectively address your specific challenges while also providing essential features like:

- **Flexibility**
  To adjust with constant regulatory changes and adapt to different jurisdictions as the company expands into new markets.
- **Efficiency**
  To transfer digital data seamlessly in its native form to analytics/auditing systems and optimize business security.
- **Integration**
  To dynamically arrange multiple systems: by using APIs, new capabilities are a simple integration away.
- **Tracking-Reporting**
  To automatically check for errors, more easily fix issues: digitalization is a clever shortcut to achieve accuracy.
- **Customization**
  To personalize forms according to the customer's risk profile, only requesting the documents that are truly needed.
- **Better customer experience**
  To offer users a digital-only and intuitive interface that enables a good adoption rate and safeguards client relationships.

Conclusion

Do you know your customer?

eKYC as a top priority for every business

Distances have shortened and the market has expanded, making non face-to-face business relationships and transactions the new "normal". The pace of regulatory changes and rising costs of compliance have made the traditional manual approach to KYC not wisely viable anymore. Especially considering how bribery, corruption, financial misconduct, and economic crimes are frighteningly evolving and increasing. The EU has been leading the way regarding customer onboarding requirements, whose scope will certainly be extended to an even greater variety of businesses and sectors. Still, even for industries that were not traditionally obliged, widespread KYC and AML compliance is rapidly becoming the norm on the international business stage.

Know-your-Costs

Most organizations are finding themselves struggling to ensure that they fully meet CDD obligations without unduly burdening their clients. The latter, in turn, have likely been a major drive for digital-oriented improvement, along with the need to intensify procedure efficiency over time. Traditional paper-based processes misspend hours of work and heighten the risk of non-standardized data collection. Both companies and customers pay the price this disservice produce.

The client onboarding needs to be smarter, more efficient, and thoroughly done to deliver a satisfactory and effortless customer experience, while complying with fraud-mitigation measures. Moreover, it must be relevant and time-bound, scalable and proportionate to the risk and resources, and it must be documented and available for inspection by regulators.

All the pigeons with one stone

Embracing the power of technology goes a long way in providing faster and more secure operations, improving customer experience, and building overarching trust. What's more, digital tools are ever more perceived as having a decisive role in the protection strategy against identity theft and economic offenses.

A cutting-edge e-KYC product reaps within one solution the four pillars of CDD lifecycle management: customers and UBOs identification, verification of their true identity, activities and source of funding, ongoing monitoring and reporting. Transparency, convenience, compliance, speed, and security are just the first benefits that come to mind. All workflows, where possible, should exploit digital processes. Times of transitions rarely come without challenges, but automation has the potential to rapidly scale compliance efforts while future-proofing the overall business. Bringing it all together, the digital and automated approach appears as the only foreseeable future for KYC.

Curious to learn more?
Check out our solution for AML & KYC compliance and sign up for a free trial!

Take advantage of what the future offers to make your business ready to face it.

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