



MITIGATING RISK WITH KYC

A tremendous amount of fuss has been made about 'new' KYC (Know Your Customer) requirement in recent years and yet I cannot recall a time (or a bank), ever, not asking the type of diligence questions we ask today at account opening, when one was applying for a loan. No one grants credit without understanding precisely who you are, where you live and work and how likely you are to repay the money lent to you. Why should we not therefore wish to reduce our risk in account opening too by asking similar due diligence questions? KYC simply takes Customer Identification (CI) to the next level.

Six years ago a handful of Swiss compliance officers encouraged me to build a risk-relevant, global database of high-risk individuals and entities, which laid the foundations of World-Check. This was a time when KYC was not a term most bankers had heard of and the requirement for PEP (Politically Exposed Persons) screening had not yet left Switzerland. This was also a time when no financial institution would ever publicly admit to screening their customers. Everything changed post September 11, 2001.

In the past five years since the tragic

event, we have witnessed a gradual and on-going, global rollout of enhanced due diligence requirements. The ever increasing desire to prevent terrorist financing, money laundering, fraud and corruption have elevated KYC and PEP checking to the first defense in this war on crime. Today, there can be no more ignorance as to the importance of knowing whom you are doing business with; and to question why one should be required to carry out such checks, could be damaging to your career.

A banker's worst nightmare must surely be, while sipping his first cup of tea in the morning, to pick up the newspaper and find his bank's name, or worse still, his own name, in association with a major criminal, splashed across the front cover. And yet it would appear that not every banker has considered this scenario when they turn a blind eye and start a relationship with someone carrying heightened risk.

Risk lies not only in banking the funds of terrorists, traffickers, dictators, corrupt politicians and arms dealers but also in extending loans and finance to such individuals as well as many others like fraudsters and identity fraudsters. There can be no worse situation than finding your institution has financed a

terrorist attack, a narcotics front company or a company supplying arms against international embargo to some crazy warlord. I also know no bank that enjoys providing a fraudster with a lavish lifestyle. KYC is precisely about mitigating such risks. It's about assessing who is looking to do business with you. It's

It's an easy enough concept: Knowing one's customers makes good business sense. Why would any banker have an issue with KYC? If one is against KYC, what precisely is one in favour of? 'Not knowing one's customers' - NKYC?

about understanding their situation and requirements. And it's very much about

preventing criminals from gaining access to our financial network. I would even go as far as to argue that the financial community has a social responsibility to ensure such procedures and requirements are enforced.

It would be naive to consider KYC as being just a one-time check carried out only at account opening. Financial institutions across the globe carry out customer screening on a regular basis. It allows them to audit millions of customers, prove their on-going due diligence and reduce risk. Such procedures, I can assure you, will uncover the most hidden skeletons (or entire catacombs!) in a cupboard you think is spotlessly clean and risk free. I have had cases disclosed to me by clients that range from uncovering Saddam's henchmen accounts in Europe to an Israeli-Peruvian arms dealer with ties to Montesinos being shown the door at a Swiss institution; from uncovering a certified anti-fraud examiner who was also the personal accountant of one of the world's largest arms dealer to middle ranking South American public servants with tens of millions of dollars stashed away in US bank accounts. The riskiest individual you may come across is not necessarily a prospective client but an existing one. Consider yourself warned.

KYC procedures also allow you to better understand your client requirements for additional products. Establishing, for example, that a client has saved enough money for a deposit on a house, means the client may well require a mortgage. The same is true if the client has inherited money or received a bonus, the bank could be offering investment advice.

KYC however is also not solely about individuals. Those with something to conceal will hide their identities and their ill-gotten gains in companies, trusts and other vehicles. The requirement to carry out KYC and PEP checking on all directors and those with signature rights on all company

accounts at your institution is well established and accepted as a norm.

KYC and PEP checking in India will have its challenges, rooted in massive branch networks including mobile branches of major banks, the magnitude of customer-bases, and the complexity of customer proof of identity. At present only about 30% of the population have accounts but in the years to come how will one handle due diligence when 50, 60 or 70% of the population will be brought under banking fold. As Indian banks become global players, as they no doubt will, they will have to operate under a mass of multi-jurisdictional requirements. All of these factors will have to be addressed. Thankfully India has technology on its side and a hunger to succeed. Whatever issues the sub-continent faces, they have already been faced elsewhere albeit on a different scale. What is certain is India has to get on with the job. There will be little understanding and zero tolerance from your global counterparts for non-compliance.

Systematic and continuous bending and breaking of 'the rules' can quite easily lead to an institution being blacklisted as a financial industry outcast under the US Patriot Act paragraph 3.11. No more dollars clearing and indeed some may say, no more correspondent relationship with any major financial institution as they choose to distance themselves from an industry pariah. This is not just a threat but reality in some parts of the world.

There are those that argue compliance is too expensive but I would draw their attention to the enormous costs of non-compliance. A case in point would be Riggs Bank, the crème de la crème of US private and diplomatic banking that after more than 160 years and after having served more than 20 US presidents, today no longer exists. The cost of non-compliance for Riggs was a loss in share value, shareholder law suits, legal fees, fines and penalties adding up to over US\$250 million. Ask

yourself whether your institution could afford non-compliance at a quarter-of-a-billion US dollars?

I have over the years witnessed bankers from around the world initially resist KYC procedures, perceiving them as 'yet another regulatory requirement'. In due course, when they have realised that KYC is a risk management process, they have found it makes good business sense.

KYC and PEP checking are the cornerstones of all AML policies and procedures. If you don't know who your clients are or what risk they bring your institution, you can stare at transactions for as long as you like hoping to uncover something suspicious and not see the skeletons in the closet staring you right in the face. ☒



About the author

David Leppan, CEO and Founder of London-headquartered World-Check which he established only six years ago, stands out as one of those fortunate entrepreneurs who have been able to make a success of their first venture in such a short time. Born in South Africa, from where he moved out when he was eighteen, Leppan has worked with Thomson Financials, in OFAC solutions and compliance areas. He has been a distinguished speaker in various international forums on KYC and PEP risk reduction intelligence.