Compliance: The Digital Imperative in Financial Services

By Michael Heffner

Regulatory compliance, including the demands of Know Your Customer (KYC), Anti-Money Laundering (AML), and Enhanced Due Diligence (EDD), continues to be top of mind for every financial services industry executive. Leaders are seeking greater transparency, execution control, and accountability through improvements that have the potential to impact across the entire organization.

As a result, there is an increasing focus on technologies that can simultaneously improve compliance capabilities and create business opportunity, efficiently.

If you think financial services compliance is already too costly, brace yourself. It's going to get worse... Much worse.

Recognizing the value of a customer-centric organization, financial services institutions are repositioning processes to improve compliance cost-efficiency and further customer relationships, allowing data integration to drive and unlock product-driven silos.

Financial services institutions are adopting robotic process automation (RPA) technology and integrating it with business process management (BPM) capabilities that deliver greater agility and flexibility, and permit greater responsiveness at a lower cost.

This perspective offers guidelines to build greater awareness, knowledge, and insight into different action paths that integrate compliance and advance digital opportunities.

COMPLIANCE CHALLENGES

The pain of non-compliance causes banks and their investors to increasingly obsess about the steady rise in direct implementation costs.

Over 80 countries now enforce some version of KYC and EDD regulations. The sweep and breadth of regulations affect every aspect of financial services institutions. Compliance activities—once directed by in-house counsel or risk management functions—now demand the full attention of executives and staff. No longer is compliance simply a project: successful management depends upon the institution's full embrace of compliance as a discipline.

Greater transparency, execution control, and accountability top both regulator and customer demands. Balance sheet pressures that raise capital requirements amidst low interest rates have led many financial services leaders to rethink established processes, structures, and business models. In some cases, it has led many global, systemically important financial institutions (G-SIFIs) to exit a region or a line of business to escape the "too big to fail" imprint and harsh regulatory scrutiny.

Thankfully, an alternative management paradigm exists. Digital can untether and manage data and process in new and previously unimagined ways. Advances in telecommunications, computation power, cloud, and an array of adaptive software enable dynamic control, enhance accountability, and improve execution.

Financial Services has befriended digital technologies. Yet, these capabilities fall far from full realization and distribute themselves unevenly. They appear more frequently in external-facing applications and rarely extend through to back-end processes or across all products and services. This gap affects financial service leaders' ability to rethink established processes, product offerings, structures, and business models. Operational effectiveness depend on:

- Fostering greater transparency, exposing new risks, and in some cases opening revenue opportunities.
- Taking advantage of existing resources that can easily simplify processes or add complexity.
- Constituting an all-in commitment to training and cultural adjustment.

Leaders must evaluate how to integrate the two levers of change—customers and compliance. The decision affects whether they create the type of customer experience through digital that can propel their organization to greater strategic advantage.

Let's look at the digital journey institutions are taking.

AWARENESS

The Impact of Customer Relationships

Customer relationships for most financial services institutions involve outward facing customer connection points that bear little or no resemblance to internal business models or operations that separate activities by service and product. Decades of decisions that previously fueled growth and profitability warrant re-evaluation now in the age of digital transformation. Leaders are looking at a number of key areas:

- Will service specializations by product continue to fuel organic growth?

- Will adoption of a regional location or new legal identity impact regulatory constraints?

- Will scale and its greater cost-efficiency contribute to and accelerate consolidation decisions across the industry?

- Will product-centered line of business (LOB) models restrict the flow of insights around risk or limit cross-sell and operating synergies?

The Cost of Compliance

Regulatory authorities differentiate themselves in multiple ways; by their jurisdiction (e.g., Federal vs. State) and by their administrative focus area (e.g. Capital Markets, Securities, Savings vs Commercial Lending). Their mandates may even conflict, resulting in inconsistent and somewhat overlapping rules, confused enforcement, and limits for information exchange and operating synergies.

U.S. banks reportedly paid $100 billion in penalties and settlements from 2008-2013 alone, according to the Financial Times. KYC and EDD go beyond a simple rule modification that affects internal decision making processes, customer disclosures, or reporting. The intensified regulations seek evidence of many of the same things that customers expect—mutual assurance and trust that the financial system delivers what it promises.

Before the financial crisis, infrastructure investments and innovation walked hand-in-hand. Since the financial crisis, institutions and their highest level management teams struggle with the opacity and complexity of their existing structure, internal control procedures, and processes. Going forward, compliance capabilities and agility to serve customers depends on how effectively institutions can reconcile interactions across their own complex structures, with the goal of an internal view that meets the array of applicable regulations.

> *[Regulatory compliance] affects almost everything we do… I can't think about our technology spend without thinking of the number of heads I have to hire to build the systems to comply with the new regulatory reporting functions.*
>
> – GOLDMAN SACHS CHAIRMAN AND CEO AS TOLD TO BLOOMBERG

ComPeer estimated the true cost of regulatory compliance for the UK investment industry at £420 million in 2012, with projections to rise past £500 million in the near term. Though these are figures for one region (UK), they nicely break down the source of compliance-associated costs across the operations. Additionally, they have relevance to U.S. institutions, as well as their peers around the globe. "Direct compliance costs account for only 31% of the total. True compliance costs (excluding fees and levies) are about twice as large as direct compliance costs." [i]

In fact, a survey reported by The Wall Street Journal found that 78% of survey respondents said the lack of integration across software systems and applications increased their compliance costs. 58% graded these systems' ease-of-use a C (average) or lower—and 42% said they don't have access to real-time, consolidated compliance data on a dashboard or other platform.

Has the volume of present regulations and tight implementation timetables triggered cost expansion and pushed aside desires to innovate? Compliance requires significant resources that include: staff specialized in compliance; training to anyone handling accounts and their management teams; and developers to modify the systems of record and reporting. Without a modern digital remedy, institutions will be stuck in the status quo.

KNOWLEDGE

Intelligent Automation for Compliance and Customer Management

Automation keeps financial institutions sane, and it offers greater consistency and control of customer information, primarily limited to the individual account level. More importantly, it helps control costs. More thoughtful, comprehensive plans can avoid duplication, streamline decisions, and ensure consistency.

However, the patchwork of older legacy systems has complicated efforts to automate compliance processes. And the lack of integration across software systems and applications increases compliance costs.

> *Few clients seem to track which regulations impact the enterprise and which specific products or services the regulations apply.*[ii] – KPMG

What does successful automation require? A clear vision. A bigger picture of your business environment.

The existence of a map makes it possible to find or create the path to successful automation. Begin to lay out this picture by assembling, organizing, and then linking rules, tasks, and data. Assembling the list of external regulators and rules is easy. Assembling the corresponding internal list of the LOB entities, their processes, as well as data systems also should not prove too difficult. Appropriately linking the two is anything but easy.

Organizing Regulations

For example, KYC is first initiated within an on-boarding procedure. Once the client, counterparty, or vendor is on-boarded, this information needs to be refreshed on an ongoing basis. Common across the procedures, firms need to demonstrate they verify a customer's identity and use "reasonable, practical" risk-based procedures to acquire four types of information.

One of these types is external verification from independent, third parties. In the U.S., E-filing requirements also force institutions to lean on systems technology to support and execute. And, as expected, EDD requirements expect additional proof:

- Evidence of proper risk management and compliance procedures in place.

- Evidence that practices are consistently followed.

The scattered, organizational structures, as well as data formats and legacy system processes considerably complicate these tasks. Ideally, a standardized, but locally responsive rule-based system could sit at the core and enable consistency, and prove easy enough to meet and adapt to locally nuanced regulation.

Various software-enabled systems offer execution control, transparency, and accountability. Many claim easy reporting and audit trails too. So compliance sounds doable—even simple—until you consider the internal reality of these auxiliary support systems.
Can you easily map the internal path of data as it's collected and processed for new customers, not necessarily a new account?

Most outward facing "customer relationship" processes quickly separate by product into different account-specific entry and access systems. Lookups of a customer rarely include dynamic or real-time data across all the customer's accounts, which makes the idea of relationship management inside the enterprise a mere pretense. The larger the organization, the more its age and breadth of service offerings determine the array of data management structures and processes.

KYC and EDD compliance affects each and every one of these systems, the policies for interaction with customers and evaluation, procedures for staff, and data handling.

Choosing the starting point for change makes a tremendous difference in the costs, and more importantly, impacts the effectiveness. KYC requirements don't just apply to a change in the customer interface; there is also a sea change in the representation of data itself.

Meaningful Data Classifications

The ready availability and access of data, as well as the speed and location of processors have completely altered the form in which data is stored. To enable greater execution control, as well as transparency and accountability, data can be separated by more than type and format. Let's take a closer look at the notion of factual, observed, and derived data.

- **FACTUAL:** The Customer Information Profile (CIP) data that KYC regulations demand represent three kinds of factual evidence: A determination of the legitimacy of an individual, the basis of their income, and the names of the parties with whom the bank exchanges the individual's funds. Quality and consistency of the input data determines the ability to match and authenticate this information against published CIP watch lists, third party data providers, and other internal data sources.

- **OBSERVED:** In addition to ongoing customer-level transaction data, the behavior of services representatives can be recorded and made available for further review. Organizations find it difficult to bring together ongoing transaction-level data across multiple products and accounts. Improved compliance depends on the ability to identify suspicious behavior proactively. It also demands customer-facing service and support representatives treat the information they access as well as the customer consistently. Understanding behavior of the customer and of the agent also benefits your business beyond stopping fraud—by improving the experience, improving cross-sell, and more.

- **DERIVED:** KYC expects institutions to score the relationship and its risk levels. The analytics and any other processes that derive information from facts or observation often drive decisions that determine the next turn. The location of the process can be Independent.

Automation Makes a Difference

Individual LOB or associated business affiliates each open and maintain accounts that create redundant, inconsistent individual customer-level data that compliance rules demand reconciliation at the enterprise level. In short, lots of silos.

Firms that dedicate resources to implement KYC/AML rules and establish enterprise-level rules and policies with LOB flexibility can simultaneously satisfy both business and compliance information needs.

> *McKinsey found Financial institutions can improve productivity and customer service by more than 50 percent if they both automate processes (prevent customer use of paper, digitize work flows, and automate or support decision making) and use IT solutions to manage residual manual operations (e.g., use software for resource planning).*[iii] – MCKINSEY

Organizations that already rely on an integrated data management view may have a head start on managing factual, observed, and derived data. They gain additional benefits when they adopt a flexible, cloud based platform. Gartner categorizes these systems with combination capabilities as intelligent business process management systems (iBPMS). These include intelligent features such as adaptive analytics, enterprise mobility, social collaboration, ad hoc processes, and cloud deployment.

McKinsey reports that organizations adopting this approach generate favorable ROI and rapid payback. How?

McKinsey reports these firms successfully create workflow systems that overlay business process management tools and connect separate legacy systems, which in turn eliminate manual data entry and related errors across end-to-end processes.

The benefits of single relationship views, often implemented through case management combined with business process management are many:

- **Integration begins with data.**
  A case record assembles customer facts, observed, and even defined data from any source. Cloud-based work platforms also increase the access, integrity, and reuse of customer data across LOBs, functions and geographies.

- **Productivity and efficiency increase.**
  Productivity and efficiency gains advance considerably with adoption of a lean approach—best processes from customer, business, and risk perspectives defined upfront.

The Advantages of Integrated Data

Data control increases and aids governance, risk management and compliance with transparency. Why? Because the platform enables consistent information to pass back and forth within different functions, readily and rapidly:

- Exceptions that inevitably arise stay on track thanks to built-in mobile and collaboration capabilities to alert and resolve issues, all in the same platform.

- Knowledge exchange is easy and efficient, allowing issues to be disposed as quickly as they occur. The results improve the customer experience, ensure accountability, and document the action, thus preserving audit control. In this regard, compliance becomes a by-product of action.

- Customer facing service and support representatives use the same, consolidated view to provide more uniform responses over time to the same customer. This dramatically improves the customer experience, as the customer no longer has to repeat information—a common frustration and complaint.

- Patterns become easier to identify and detect when ongoing transaction level data across multiple products and accounts are brought together in a single view. Staff can be trained to understand, interpret, and record the same information in the same places improving overall record quality.

- Data in the case record can trigger analytic processes to score the entire relationship in combination with external information. Complex analytical models for fraud detection, risk management, cross-sell, and compliance (as well as audit controls) can be developed and applied cost-effectively.

As you can see, people, processes, and data all benefit from the single case relationship view. This advanced approach enables the entire enterprise to improve its practices while concurrently meeting its regulatory requirements.

An intelligent automation work platform—with all the capabilities Gartner identifies—opens opportunities for better compliance and greater insights into the customer that can detect and address risks and opportunities sooner, more consistently, and holistically for the relationship…not just for a single product or service account.

ACTION

Organizing customer information. into a single, flexible case record allows institutions to more easily adhere to compliance, while simultaneously enhancing due diligence, managing risks, and generating revenue.

How should you choose the right approach for your organization? Most theories of change emphasize a few ground rules to avoid failure:

1. Obtain buy-in and input from those people the changes impact.
2. Ensure leadership understands and communicates the objectives—clearly, repeatedly, and consistently.
3. Align the objectives to strategic purposes, performance expectations, and measurements.

Technology investments must mitigate both direct and indirect compliance costs. But, only some offer future-proof assurance through flexibility—capabilities that deliver efficiency but also strong, comprehensive and repeatable information and procedures for customer-related activities, as well as counterparty interactions.

Many firms have already tested this theory as part of the work undertaken to become FATCA-compliant when, rather than just reviewing U.S. citizens for complete know-your-customer documentation, the opportunity was taken to review (often on a risk-based approach) the entire client database to cleanse and refresh the information held, as well as fill any gaps.[iv] – THOMSON REUTERS

But do those systems also support the growth of your business and the ever-changing needs of your customers?

Several software-enabled approaches can bridge multiple systems. The greater value—as previously referenced—comes from one logically consistent system. The approach you choose should at the very least resolve your biggest pain point, as well as unify disjointed, inconsistent, and redundant data records from the various sources.

Adopting An Agile Digital Platform Approach

Adopting an agile application platform approach like the Appian Digital Transformation Platform™ simplifies assembly of individual customer information from across multiple sources, LOBs, and geographies. Further, a platform that is BPM-powered makes the job even easier with a data-centric focus that unifies data and process into a single, foundational case record, creating a single, complete view of the relationship.

Different business functions and different LOBs no longer need to waste time and development effort constructing their own customer views (let alone search for the right information from across systems), as they use the same singular case data.

An agile platform, available on-premises or in the cloud, makes it possible to develop a process once and then reuse it on different account level data within the customer relationship record. The evolving changes in your customer, as well as regulations, become simpler to deploy and ensure consistency and control. Technology investments must mitigate both direct and indirect compliance costs...and offer future-proof assurance through flexibility.

Your enterprise can operate more effectively this way, too. The combination of information modeling and rules-based processing enables organizations to address the unpredictable as easily as the routine. As noted earlier, the rise in costs exceed the multiple regulators and regulations that create inefficiency and process gaps. You can correct poorly structured processes by embracing the perspective of your customer.

Finally, emergent intelligent automation makes it easier to communicate and share the bigger picture of overall information flow, rather than the step and stage of process. The less structured processes make it possible for information to determine the next best step, rather than the other way around.

What will you do with your greater awareness, knowledge, and insight into different action paths?

Take the next step and contact Appian to unify your process and data, integrate compliance across your entire enterprise, and significantly advance your digital capabilities.

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Mike Heffner leads the global Financial Services Banking, Capital Markets, and Insurance industry team at Appian. The team is responsible for engaging with customers, partners, and analysts to solve digital transformation challenges. Mike is a frequent speaker at industry events, and a contributor on thought leadership trends and responses in the financial services sector. Mike brings innovative approaches to problem solving to his role, including extensive leadership experience in operational efficiency, transformation, and re-engineering. Prior to Appian, he was Managing Director, Business Transformation at State Street Corporation, held management roles at Charles Schwab & Co., and Accenture's Creating-Financial-Markets-Advantage executive group. Mike holds a BSBA in Economics from University of South Carolina, and an MBA from Babson College.

i. HedgeWeek, The True Cost of Compliance

ii. KPMG Compliance Risk Management Survey

iii. McKinsey Automating the Bank Back Office

iv. Thomson Reuters Cost of Compliance Report