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Six steps towards a concrete KYC procedure

By Dunstan Magro September 2, 2019

Dunstan Magro, managing partner of WDM International outlines the steps needed to ensure a concrete KYC procedure that can benefit both parties.

Know Your Customer, or KYC, is a standard client due diligence process usually performed by persons who want to engage in business transactions with potential or existing clients. Although KYC is synonymous with legal, regulatory and compliance requirements in relation to anti money laundering (AML) matters, KYC is a good business practice to adopt since it helps in the understanding of the client's profile and whether it is a client worth doing business with.

KYC comprises the identification and verification of the client's background and nature of business as well as the sources of funds and wealth. Getting detailed information about clients protects both parties in a business transaction and safeguards their relationship. Thus, the KYC process not only protects all stakeholders within an industry, but, given that it is carried out in the best interest of all parties involved, it serves an important purpose for providing superior service, preventing liability and avoiding association with money laundering and financial crime.

The importance of KYC when engaging in a new business transaction is evident from all stakeholders' point of view. Although these rigorous checks can at times be a burdensome process, they invariably create a secure and trustworthy environment to enable financial activities. Clients will feel they are working with legitimate institutions and professionals who are educated in the understanding of whether their clients are ready to carry out a particular transaction or not. Building trust between the parties in the business relationship is the key to success and for the furtherance of a positive financial and economic environment.

It is important to keep in mind the basics of implementing robust KYC procedures as part of a comprehensive AML compliance program. KYC should always be implemented whenever one enters into a business transaction, irrespective of whether this concerns, for example, the identification of a strategic partner, the evaluation and selection of potential investors, or the acquisition of targets and new clients.

Essential elements of good KYC procedures comprise:

1. **Risk assessment –** this should always be the starting point in determining whether to accept a business relationship or not. Typical risk factors to be considered in calculating the overall risk score of the client include the nature of the client's business and geographical location, the type of service being offered and the extent of face-to-face interaction with the client.
2. **Mitigating measures –** these need to be designed according to the risk posed by the client in order to bring the exposure to the client's risk to acceptable levels, in accordance with the organisation's preestablished risk appetite.
3. **Due diligence procedures –** the resulting level of risk, after taking into account the mitigating measures adopted to minimise such risk, will establish the extent of due diligence procedures to be performed. A higher level of risk will trigger the need for enhanced due diligence procedures. Such procedures usually involve knowing who the ultimate beneficial owners are, where clients are getting their income from and gauging their capability to conduct the proposed transaction. These checks are vital to avoid getting entangled in business relationships with potential clients who have participated in shady dealings or other illegal activities.
4. **Ongoing monitoring –** transaction monitoring consists in using the subject person's knowledge of the client to identify any transactions that are unusual or which fall outside the normal parameters established for the client. This can only be effective if the information, documents and data held on the client are up to date.
5. **Compliance training –** to ensure that employees are familiar with KYC procedures including their roles and obligations in this regard.

6. **Independent audit –** an independent review of the organisation's KYC procedures will provide the organisation with a clear outline of issues requiring urgent attention to ensure regulations and policies are complied with.

   As business volumes and data complexity increase exponentially, KYC compliance has taken on a bigger role. There is an ever-growing recognition that compliance needs to be a top-down culture across the entire organization for it to be effective. While the nature of compliance and its rationale has not changed, its priority and position within an organization has changed. Rather than being a distraction or inhibition to business, the contemporary view on KYC today is that compliance brings along real value to the whole organisation. Indeed KYC can add value to your business.

   By Dunstan Magro, managing partner of WDM International and member of IR Global, the world's largest exclusive network of advisory firms.