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# AML and KYC Compliance in the COVID-19 Era

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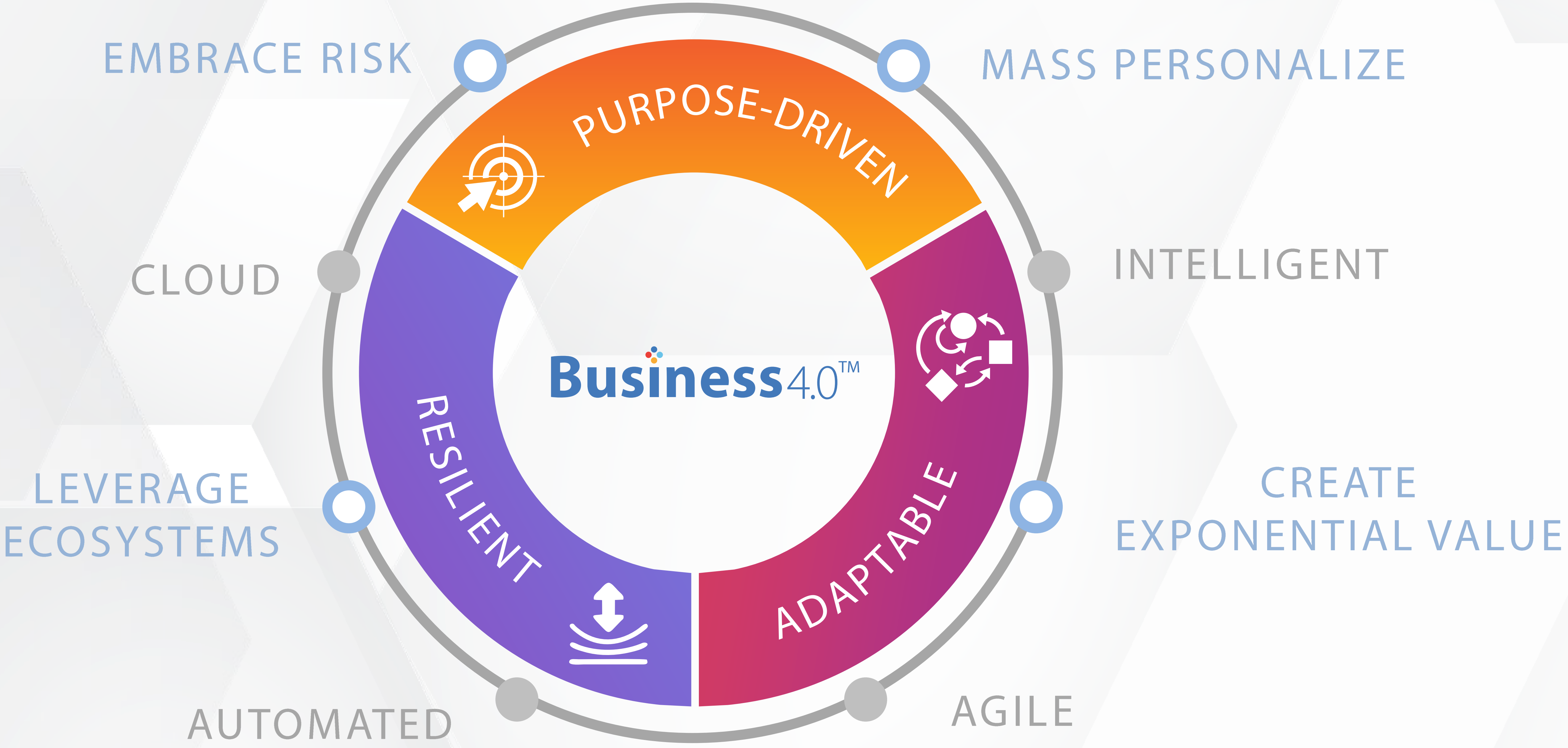


# About the Authors

## Vaibhav Goel

Vaibhav Goel heads the Analytical Products Industry Advisory Group of TCS' Banking, Financial Services and Insurance (BFSI) business unit. He brings to the table more than 12 years of industry experience in regulatory compliance product consulting and is responsible for strategy, presales, advisory, solutioning, and thought leadership. He holds a Bachelor's degree in Electronics and Communication Engineering from U.P. Technical University, Lucknow, India, and a Post Graduate Diploma in Information Technology from the Symbiosis Centre for Distance Learning, India.

## Swati Singh

Swati Singh is a product consultant in the Analytical Products Industry Advisory Group of TCS' Banking, Financial Services and Insurance (BFSI) business unit. She has over 12 years of experience in the banking and IT domain with special focus on regulatory compliance and analytical products implementation, configuration, advisory, infrastructure and solutioning. She holds a Bachelor's in Computer Applications from Ranchi University, India, and a Master's degree in Computer Application from Sastra University, Chennai, India.

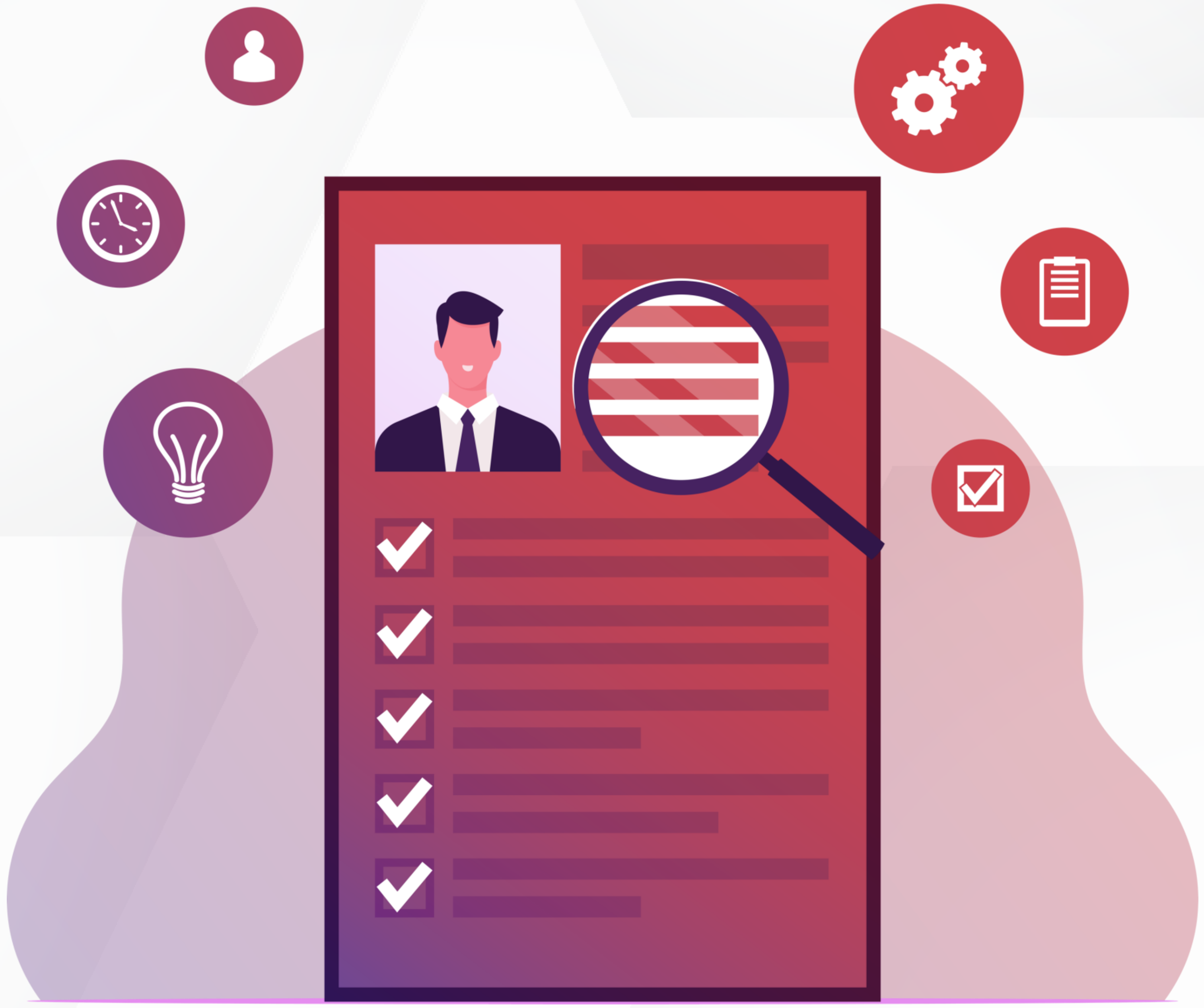

# Abstract

The COVID-19 pandemic has created a serious and challenging situation for all industries including the financial services sector. The crisis has snowballed into a global health emergency that has suspended generally applicable business norms. Governments' response to the crisis spanning lockdowns and social distancing has resulted in limited staff at branches and back offices. To cope with the situation, financial institutions are nudging customers to use digital channels more and more, which comes with its own challenges around fraud and money laundering. Money laundering activities through banking channels may well go up necessitating robust customer onboarding and know your customer (KYC) processes. In addition, compliance teams will need to establish adequate vigilance processes to track malicious activities. The way forward for financial institutions lies in adopting artificial intelligence (AI) backed tools to proactively detect fraud and take measures to prevent losses. This white paper discusses the risks the financial services industry is currently grappling with as regards money laundering and KYC processing and suggests measures to better manage them.

# Assessing Challenges in AML and KYC Compliance

The COVID-19 crisis has triggered substantial disruption in business and market conditions, in turn increasing financial crime, fraud, other forms of misconduct, and misuse of government funds or international financial assistance by illicit actors. As a result, the Financial Action Task Force has recommended best practices and policy responses to new money laundering threats and vulnerabilities emanating from the COVID-19 crisis.[1]

Due to the pandemic, governments and regulators have relaxed certain compliance obligations applicable to both private and public enterprises to ensure business continuity. In some cases, governments are guaranteeing loans and funds disbursed through banking channels. Given that the government will bear the risk in such cases, this could potentially result in bank personnel relaxing their vigilance while reviewing customers. Unavailability of staff, coupled with remote working, has already negatively impacted overall compliance monitoring and controls, and government aid measures have only added to the pressure to remain vigilant and prevent misuse of banking channels by illicit players.



[1] Council of Europe, COVID-19-related Money Laundering and Terrorist Financing Risks and Policy Responses, May 2020, Accessed June2020, https://www.coe.int/en/web/moneyval/-/covid-19-related-money-laundering-and-terrorist-financing-risks-and-policy-responses

# The Digital Path to Compliance

Banks periodically review their internal systems to identify gaps in supervision and fraud detection processes as required by existing compliance norms. Banks have also established robust governance models to monitor transactions which are in turn approved by board committees for compliance supervision. However, given the rapidly evolving situation, banks must assess whether their existing supervision and governance processes are sufficient. We believe that such an assessment will reveal that the processes are not adequate for the prevailing situation. In our view, financial institutions must shift from static methods of detecting fraud -- pre-configured scenarios and patterns without in-built intelligence to self-adapt to the evolving nature of financial crimes -- and opt for end-to-end digitalization of their systems by adopting intelligent technology backed solutions. The ongoing pandemic offers an opportunity for financial institutions to rapidly deploy cutting-edge technology driven applications that are resilient and adaptable to tackle evolving scenarios in the future as well.

# Digitalizing AML and KYC compliance

Lockdowns and physical distancing have imposed constraints on the verification of KYC documents. Replacing physical document verification with digital IDs issued by governments will decrease the pressure on field staff and at the same time increase customer convenience. Physical verification can be shelved till the situation starts improving. In case of high-risk geographies, this measure can be restricted to enable important activities such as disbursement of government aid to individuals or businesses. Introducing video banking facilities to interact with existing as well as prospective customers can also help. Video collaboration tools can help banks overcome the limitations emanating from the crisis while customers will be able to experience a closer connect with their banks.

Social media is an excellent source of behavioral insights that can be of immense help to identify anomalies in customer behavior and detect potential financial crimes. Incorporating analytics frameworks into KYC systems will ensure that no source of information is overlooked while onboarding new customers. Similarly, analytics frameworks must be embedded into periodic review processes to identify behavioral changes among existing customers. Leveraging artificial intelligence (AI) and machine learning (ML) tools can help facilitate smart customer onboarding, enable stringent due-diligence, and review of historical transactional data residing on different systems to identify hidden patterns and discover undetected frauds and money-laundering activities.

This will help banks to exercise better control over fraud and money laundering, especially given the increase in such crimes due to the ongoing pandemic.

Though it is indisputable that AI and ML powered solutions can help tremendously in controlling financial crime and money laundering, and a few banks are already experimenting with them, some financial institutions are skeptical about their capabilities and benefits. However, increase in financial crime triggered by the crisis has made it imperative for banks to deploy AI and ML solutions to monitor the source and destination of COVID-19 donations, track and report misuse of bailout funds, and effectively perform KYC verification and customer onboarding in compliance with social distancing norms.

Enhancing the limits for e-wallet payments and reducing charges for online funds transfer using banking channels can also help. This will not only support social distancing but also help in reducing the AML compliance burden on banks as the source and destination of the money thus transferred can be easily tracked. Casinos and gambling platforms are another avenue for laundering money. Steps must be taken to track illicit activities in casinos and gambling dens given physical monitoring of high risk activities will not be possible in the prevailing situation. Regulators must recommend mechanisms to track these platforms and prevent money laundering transactions.

Implementing change programs in-house may pose challenges as regards technology expertise and talent with the requisite skills. Financial institutions must consider engaging with the right service provider with in depth knowledge of the latest technological advances and trends, regulatory requirements, and an understanding of individual organizations' business context. However, care should be taken in choosing the right service provider after a detailed market analysis.

# The Way Forward

While the COVID-19 situation is still evolving in many countries and the final economic impact is yet to be ascertained, the International Monetary Fund (IMF) has opined that the current downturn could be worse than the 2008 financial crisis.[2] With so many job losses and large sections of the population facing financial hardships, it is imperative that illicit actors are prevented from exploiting weaknesses in the financial system.

The way forward for financial institutions lies in implementing technology backed initiatives to tackle rising financial crime and money laundering activities and prevent misuse of funds meant for driving economic recovery in the post pandemic phase.

[2] International Monetary Fund, The Great Lockdown: Worst Economic Downturn Since the Great Depression, Mar 2020, Accessed June 2020, https://www.imf.org/en/News/Articles/2020/03/23/pr2098-imf-managing-director-statement-following-a-g20-ministerial-call-on-the-coronavirus-emergency

# Contact

For more information on TCS' Banking & Financial Services, please visit https://www.tcs.com/banking-financial-services

Email: http://bfsi.marketing@tcs.com

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