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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

## ASIFMA Comments on the Bank of International Settlements' ("BIS") Basel Committee on Banking Supervision Consultative Document on proposed revisions to its guidelines on *Sound management of risks related to money laundering and financing of terrorism*

In November 2016, Bank of International Settlements' ("BIS") Basel Committee on Banking Supervision issued a Consultative Document entitled, "Revised annex on correspondent banking: Correspondent banking – revisions to the Basel Committee guidelines on the sound management of risks related to money laundering and financing of terrorism" and requested feedback by 22 February 2017[1].

The Asia Securities Industry & Financial Markets Association (ASIFMA) is the leading capital markets association in Asia with over 100 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers.

ASIFMA and its members fully appreciate the vital importance of developing regulations and systems that improve Know Your Customer (KYC) documentation and procedures and in that spirit ASIFMA, on behalf of its members, is pleased to submit our comments on the Consultative Document.

The comments below refer entirely to Paragraph 6bis in Annex 4 of the Consultative Document, which relates to KYC utilities. The impact of KYC utilities goes beyond correspondent banking and includes Capital Markets clients and counterparties.

**<u>Current State</u>**

There are essentially three types of sources whereby market participants can obtain KYC documentation from third parties: (1) public databases, (2) data repositories that merely collect data and (3) utilities that not only collect and store the data but also perform verification activities and quality checks. In addition, these databases, repositories and utilities use different sources of information including other utilities, public databases, or the end client directly. Therefore, regulators need to clarify the definition of utilities. Also, the choice between those three by the Financial Institutions (FIs) handling an account opening will depend on the relationship with the end client, cost/benefit and the priority of the account opening.

[1] See: http://www.bis.org/bcbs/publ/d389.pdf

The current method where each FI is performing KYC on every customer (including correspondent banks) is costly to operate, contains areas of duplication across firms and negatively impacts customers, who often have to provide the same information to numerous counterparties.
KYC utilities are tools that could significantly alleviate this problem, as they provide secure, shared platforms for FIs and clients to exchange KYC data. In our opinion, KYC utilities[2] are private or public data bases containing data and verification documentation to allow an FI to satisfy its legal and regulatory obligations to conduct due diligence on its customers and in some circumstances counterparties.

As the CPMI observed in its report[3], using a KYC utility can introduce many benefits, which we believe go beyond correspondent banking, including:

- the number of times an FI must send the same information could be greatly reduced;
- the accuracy and consistency of the information could improve, as FIs would only maintain one set of updated information;
- the use of a single template might promote the standardisation of the information that is provided as a starting point for KYC obligations;
- the use of a central KYC utility might speed up the process; and costs could be reduced thanks to a lesser amount of documentation being exchanged.

Currently, there are at least four major private sector KYC utilities globally. The degree of coverage and standards of documentation collected by KYC utilities varies significantly between the KYC utilities and across jurisdictions based on the standards set by member FIs and the utility's own assessment of requirements. The business model of a number of KYC utilities in the Capital Markets space allows free onboarding for buy-side clients, which typically include large fund managers. Consequently, there have been instances where such clients have told their FIs to obtain KYC documentation from a non-member KYC utility provider. The FI is then faced with the choice of either discontinuing the client relationship or joining a KYC utility whose KYC standards may be lower than its own.

Another KYC utility trend is towards country specific repositories and utilities, driven by the government (e.g. India and planned for Mexico and Singapore) or by the financial industry (South Africa). This trend may create further fragmentation in KYC country requirements and may increase the cost of doing business as it becomes very complex for a cross-border FI to apply an efficient standard bank-wide model whilst end clients that operate globally will still need to upload different sets of documentation in every country they operate in. Moreover, we are concerned about a monopoly model at a country level from the perspective of encouraging competition and promoting efficiency and innovation.

ASIFMA and its members appreciate the recognition of the growing utilization of KYC utilities in the client onboarding and periodic review process. Despite holding a lot of promise in alleviating the regulatory burden on the industry, KYC utilities are not yet a fully reliable source and lack significant mass. Specifically, ambiguity and uncertainty around the following five factors are hindering the greater adoption of KYC utilities by FIs.

2 The four main utilities are Swift, Thomson Reuters, KYC.com and Bloomberg. In February 2017, Clarient was purchased by Thomson Reuters.
3 http://www.bis.org/cpmi/publ/d147.pdf

- The lack of a regulatory framework for KYC utilities allowing FIs to conclusively rely on the information and documentation contained therein as if they received the information and documentation directly from the client;
- The need for standardization and harmonization of KYC documentation requirements by regulators;
- Limited interoperability among KYC utilities;
- Cybersecurity and data confidentiality issues associated with maintaining data on a utility; and
- Material outsourcing and data offshoring constraints

Regulatory Framework for KYC utilities

Critically, in order to allow KYC utilities to gain in adherents, a regulatory framework needs to be created in order for the FIs to conclusively rely on the data and documentation contained in KYC utilities as if they received the information and documentation directly from the client, to fulfill regulatory requirements. Without such a framework and design principal endorsement, FIs will have reservations in using KYC utilities for any onboarding or review processes. This can be achieved through a regime of endorsement or licensing of utilities with applicable requirements for audit and validation. Consequently, regulators should create a framework for KYC utilities that would facilitate FIs to use the KYC utilities to meet their regulatory or legal requirements by:

- Identifying the documentation and data to be collected taking into account the standards of the jurisdiction where the documentation is issued and those of the jurisdiction where the documentation is to be formally used;
- A method for the removal of any incomplete, inaccurate or expired information or documentation; and
- Creating independent monitoring and testing requirements

Standardization and Harmonization of KYC Documentation Requirements

An issue acute to the Asia-Pacific Region is the divergent KYC documentation standard between jurisdictions. For example, KYC requirements in Hong Kong, India and Indonesia differ considerably, while those within the European Union are of a more uniform standard. This divergence is cumbersome when attempting to "passport" a client to trade throughout the Asia Pacific Region. Based on these differing standards, KYC documentation despite in many cases having the client being onboarded in an FATF country must often be "repapered" for each jurisdiction creating significant and time consuming delays[4]. Other challenges include: uncertainty around cross-border data privacy issues; country/bank differences around the legal status of the document, format or content of documents; uncertainty on how regulators may respond as utility services gain traction and, public sources for data may be less reliable.

If an industry KYC standard were established, it could support the financial industry and adoption of KYC utilities to facilitate efficiencies in the collection, processing and maintenance of customer documentation and ASIFMA would be willing to assist benchmarking and Working Group discussions in facilitating the proposed creation of a capital markets client KYC standard.

4 Examples include the need for certified true documentation copies in Hong Kong and verification of authorized signatories in Singapore.

Interoperability and Documentation Requirement Harmonization Among KYC Utilities

Based on the business model of private sector KYC utilities, clients often seek to onboard to one of the four major utilities. However, in a number of instances, FIs may only be members of one or two of the KYC utilities, whereas a client or potential client may be a member of a different KYC utility.

This issue could be simplified by further uptake of Legal Entity Identifiers (LEIs). An LEI is a unique ID associated with a single corporate entity. A global, standardised LEI system would enable international organisations to more effectively measure and manage risk, and improve operational efficiencies and their customer service. It would also facilitate regulators to better aggregate and share information to effectively monitor risks[5] as LEIs could be shared across KYC utilities, allowing global mapping. If an entity were required to create an LEI as part of their KYC utility on-boarding, it would ensure that legal entities can be properly identified at source, as LEIs map with complete precision, in comparison to their identification being tied to single BICs which do not map with total precision to legal entities (as some entities may have more than one BIC while other BICs simply identify the parent companies or larger entities within which the individual legal entities sit).

In addition, the standards of that utility may be different than the FIs standards for the jurisdiction. As such, in certain cases clients may seek to onboard to the KYC utility with the lowest requirements thereby in a sense dictating the KYC requirements to FIs and potentially utilities based on their market share. Consequently, a key for KYC utilities to gain a critical mass would be to facilitate interoperability among the KYC utilities by allowing access for members of other utilities potentially through reciprocal arrangements and harmonizing jurisdictional documentation standards. Increased harmonization and a KYC industry standard will also facilitate interoperability between the existing utility providers.

For true interoperability and harmonization, there needs to be a regulatory discussion (culminating in common agreement) on:

- what information and data sets can and cannot be shared;
- the mechanisms to allow for the storage and or exchange of more sensitive information (and given the increasingly digital consumer experience, a certain flexibility needs to be factored in to any policy or regulatory framework); and
- the importance of including the various non-bank entities that support the financial system, whom often have a more holistic and global view of the system, for example funds transfer facilitators and message exchanges e.g. SWIFT

Cybersecurity and Data Confidentiality Issues Associated with Maintaining Data on a Utility

As KYC utilities increase in size and store more client information, hacking may result in the leakage of a greater volume of confidential financial information and personal data. Data privacy issues, especially for utilities that operate across borders, need to be addressed. This will be best achieved when banks, utility providers and regulators work together to exchange information.

Consequently, it is critical for regulators, KYC utilities and their FI members to agree on a comprehensive set of standards to ensure acceptable levels of cybersecurity for those who deposit data and documentation with a KYC utility.

5 http://www.sifma.org/issues/operations-and-technology/legal-entity-identifier/overview/

Material outsourcing and offshoring constraints

The current regulatory or legal limits on material outsourcing and data offshoring are an impediment to the adoption of KYC utilities. Local laws may for example prevent customer data from being stored outside the country and the use of a KYC utility may constitute a breach of these requirements. We recommend a relaxing of standards to allow for more efficient KYC onboarding for participants. While the current discussion of data issues with regards to KYC utilities, and issues around data-definition, quality and standardisation are important, without resolving inconsistent data restrictions that FIs face through numerous different data privacy, outsourcing and localisation laws, the issues at the heart of AML/KYC, information sharing platforms will never be resolved.

**ASIFMA Proposed Revision to Paragraph 6bis**

Paragraph 6bis is quoted below with our proposed additions in ***bold italics***:

> Supervisors recognise banks' growing use of third-party, or KYC utilities ***(Private or Public),*** databases in obtaining customer information. Different types of information may be contained in such databases and used by banks for different purposes, such as:
>
> (a) helping identify the customer, by providing identification information;
> (b) collecting information supporting the risk profile;
> (c) in some cases, serving as an external source of verification.
>
> Such utilities may be used at different stages and for different ***types of clients***, for instance at account opening for obtaining basic information, during the course of the relationship to update the information, or on an ongoing basis to assist banks with gathering information for their risk assessment process. Banks should take into account international standards, which require consideration of the reliability of the source[6] and compliance with applicable national laws, which may prescribe certain customer identification or verification procedures.

***Countries should seek to work together through regional bodies to standardize documentation requirements for Financial Institutions and large market participants globally[7]. In addition, these regional bodies should seek to arrive at a standard international KYC documentation model including allowing for the cross-border sharing of information, which would be assessed for compliance as part of a mutual evaluation process. To achieve critical mass adoption, essential for the success of KYC initiatives, the issue of risk liability must also be resolved with agreement across regional jurisdictions. Furthermore, regulators should examine prevailing global practice standards and seek to create a regulatory framework for utilities as soon as possible where deemed necessary in order to remove legal impediments to sharing of information cross border and allow Financial Institutions to conclusively rely on the data and documentation collected as if they received the information and documentation directly from the client.***

6 Footnote 18 in Section 6bis: For instance, FATF Recommendation 10 requires "(a) identifying the customer and verifying that customer's identity using reliable, independent source documents, data or information. (b) Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner, such that the FI is satisfied that it knows who the beneficial owner is. For legal persons and arrangements this should include FI's understanding the ownership and control structure of the customer. (c) Understanding and, as appropriate, obtaining information on the purpose and intended nature of the business relationship." Interpretative Note to Recommendation 10 states "the relevant identification data may be obtained from a public register, from the customer or from other reliable sources".

7 The BIS General Guideline to account opening referred in this Guideline could form an initial baseline for such standardization.

***KYC utilities should also seek create a framework for interoperability which would allow financial institutions and documentation for associated clients to:***

> ***a. be obtained from all of utility sources;***
>
> ***b. reduce any potential arbitraging of KYC documentation requirements by institutional clients***

Banks should also be alert to the risk of identity theft, and take into account the fact that a database may help establish that a customer exists and gather information on that customer. However, the database may not necessarily confirm that the person the bank is dealing with is that customer. ***Based on current and emerging identity theft and other cybersecurity risks, Governments can assist the development of KYC utilities by enhancing and regularly assessing their cybersecurity and privacy frameworks. It would be beneficial for the industry if regulators would also require KYC utility processes to be documented and available for inspection to promote greater transparency and accountability in this niche ecosystem.***

***Furthermore, data privacy issues, especially for utilities that operate across borders, need to be addressed. This will be best achieved when Financial Institutions, utility providers and regulators work together to exchange information.***

Regardless of the potential efficiencies and innovations that standards and KYC utilities may bring, they will ultimately not meaningfully reduce the cost of KYC compliance without greater collaboration with the public sector as without increased clarity and certainty in regulatory and supervisory expectations, banks will continue to build-up and maintain their own AML, KYC and CFT systems.

Thank you for this opportunity to comment on your Consultative Document. We look forward to supporting your continued work towards the adoption of KYC utilities and would welcome the opportunity to discuss our input in further detail.

Sincerely,

Mark Austen
CEO
ASIFMA