True Cost of AML Compliance – Asia-Pacific

Regional Synopsis
2019

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Background & Objectives

LexisNexis® Risk Solutions has conducted a global survey of its True Cost of AML Compliance study. The following report presents findings for the APAC region.

Specific objectives included to:

» Identify the drivers and influencers impacting AML compliance (and change);

» Understand spending trends for AML compliance, including:

  » How spending is divided by cost of compliance area (e.g., sanctions, transaction monitoring, technology, KYC due diligence, etc…);

  » The human resources component of these costs, particularly numbers of FTEs for compliance and sanctions screening; and

  » The processing time component (e.g., length of time to complete customer due diligence by type of client/entity);

» Determine the business impact of the AML compliance environment, particularly with regard to new regulations and provisions;

» Identify the challenges and opportunities associated with AML compliance, including with non-bank payment providers; and

» Understand the role of technology with the above.

Methodology

LexisNexis® Risk Solutions retained KS&R, a global market research firm, to conduct this True Cost of Compliance research study.

Data was collected by phone during early-to-late March 2019, with a total of 233 completions distributed across 4 Asia-Pacific markets as follows:

Total	Indonesia	Malaysia	Philippines	Singapore
233 complations	63 completions	50 completions	50 completions	70 completions

Respondents included decision makers within the financial crime function who oversee KYC remediation, sanctions monitoring and/or AML transaction monitoring. Organisations represent banks, investment firms, asset management firms, and money services bureaus.

LexisNexis® Risk Solutions was not identified as the sponsor of the research in order to lessen potential for brand bias.

In this report, firms are referred to in terms of their asset size. For this study, these are defined as: Small asset size – having <US$10B total assets, Mid/large asset size – having US$10B+ total assets. Financial institutions are also referred at times by their acronym FI (or FIs if plural).

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Key Findings

1. **The projected cost of AML compliance across Indonesia, Malaysia, the Philippines and Singapore combined is estimated at US$6.09 billion annually.** The cost of AML compliance differs by market and is a function of each country's number and size of financial institutions. Singapore represents the highest cost of AML compliance based on these factors, contributing just over half of the total cost (US$3.13B).

2. **The average annual cost of AML compliance for mid/large asset-sized financial institutions** in Indonesia, the Philippines and Singapore ranges between US$11.95M and US$13.93M; it is somewhat lower among mid/large Malaysian FIs.

   » AML costs have reportedly risen by 9% - 10% during the past two years and are expected to continue at a similar rate during the next year.

3. **Mid/large financial firms have significantly larger annual average compliance outlays** than smaller firms, which range between US$1.18M and US$2.08M. Since labour represents a sizeable portion of AML compliance spend, this is one driver for larger costs among larger firms. Additionally, mid/large firms have taken various labour-related steps to address the impact of non-bank payment provider/system risks and challenges, including expanding training, operations screening hours and/or size of compliance teams.

4. **Use of newer technologies/services is similarly limited** across smaller and larger firms.

   » While cloud-based KYC utilities usage is most common, current usage of other newer technologies is limited in Indonesia and the Philippines.

   » Some Malaysian and Singapore FIs have begun using in-memory processing and unstructured text analysis.

   » Across markets, though, financial institutions report being able to monitor online transactions for criminal behaviour, with Singapore FIs more likely than others to also be monitoring digital identities. Those currently without these capabilities indicate a likelihood to invest in them during the next 3 years.

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Key Findings

5 **Business de-risking is a top driver among financial institutions in the APAC region**, though significantly more Indonesian firms (78%) place it at the top compared to those in other markets. This is a particularly high risk financial sector, with money laundering connected to non-drug criminal activity and a history of smuggling, the proceeds of these illicit activities are easily hidden offshore. This adds additional risk to financial firms and makes de-risking even more important.

6 **For Indonesia and Malaysia, AML compliance is viewed as having a positive impact** on both productivity and customer acquisition. This suggests that financial institutions in these markets recognize that better KYC and data on customers can benefit not only the compliance function, but also marketing and business development; the more one knows about customers, the more that new products and services can be positioned towards them.

- There is more mixed reaction from Philippine and Singapore FIs, with particular concern about job dissatisfaction among Filipino firms.
- The above could be compounded by an expected increase in alert volumes and cost increases over the course of the year.

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Key Findings

7. **Non-bank payment providers are proving to be a new challenge** for compliance organisations.

   » The use of non-banking financial industry has become a new trend for money laundering. Not surprisingly then, suspicious activity reports have involved non-bank payment providers, resulting in an increase in the risk of conducting correspondent banking, alert volumes, and resource and technology costs.

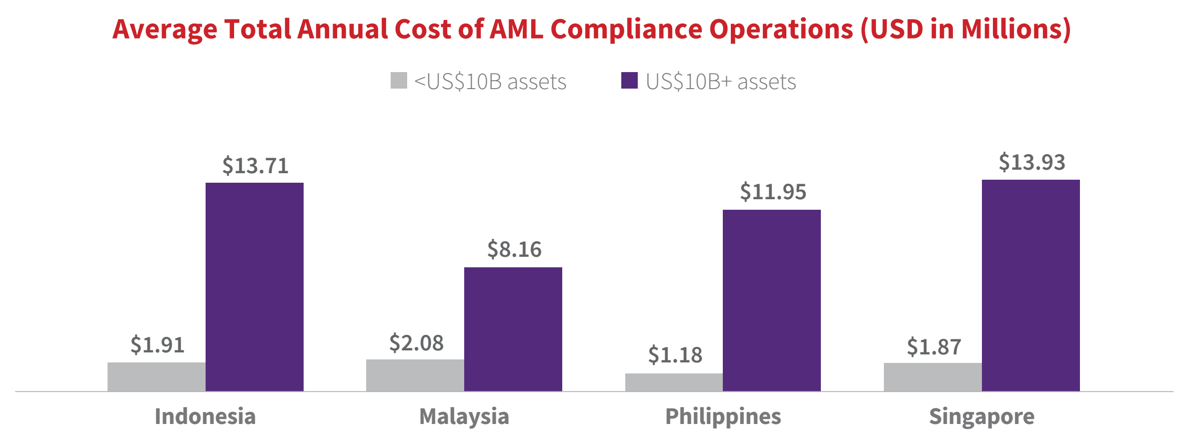
   » In response to the impact from these providers, a number of financial firms have created a team to evaluate emerging payment technologies, implemented more rigorous training, migrated to dynamic monitoring, or implemented FinTech/RegTech. But, as noted earlier, there has also been an increase in labour-related initiatives which adds to the cost of compliance.

8. **Findings show that firms which use a mix of compliance technologies have a lower cost** per FTE and are able to conduct due diligence and clear alerts faster, with less negative impact on staff job satisfaction / productivity and new customer acquisition efforts.

The average annual spend for AML compliance is significantly higher for mid/large financial firms across APAC study countries.

As shown on subsequent slides, labour represents a sizeable share of annual AML compliance spend, with larger asset-sized firms having significantly more FTE staff.

Further, a number of mid/large firms indicated having addressed the impact of non-bank payment provider/system risks and challenges through labour-related initiatives, including expanding operations screening hours and / or adding more compliance staff.

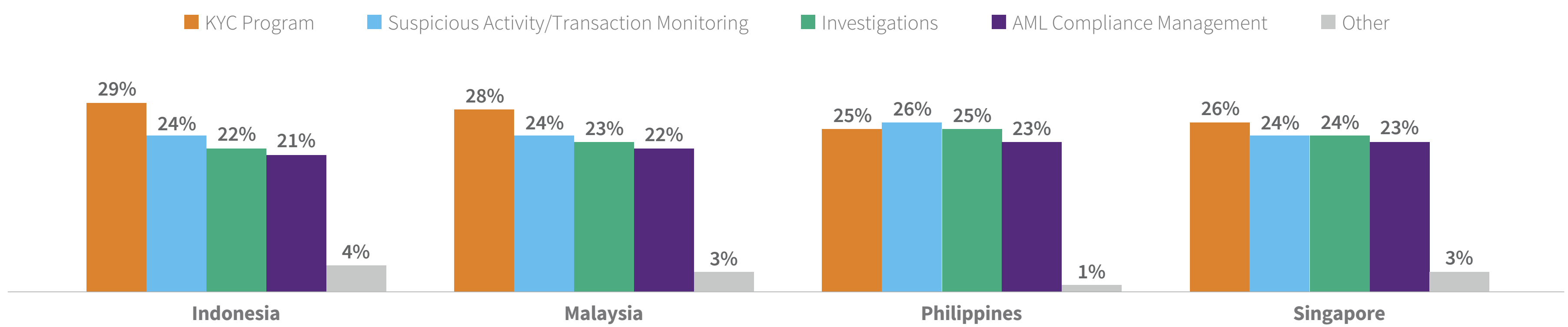


* CAUTION: small number of cases, data should be used directionally only 1 ThreatMetrix® H2 2018 Cybercrime Report
** Based on self-reported numbers and likely recall; not meant to be exact; may increase or decrease based on seasonality

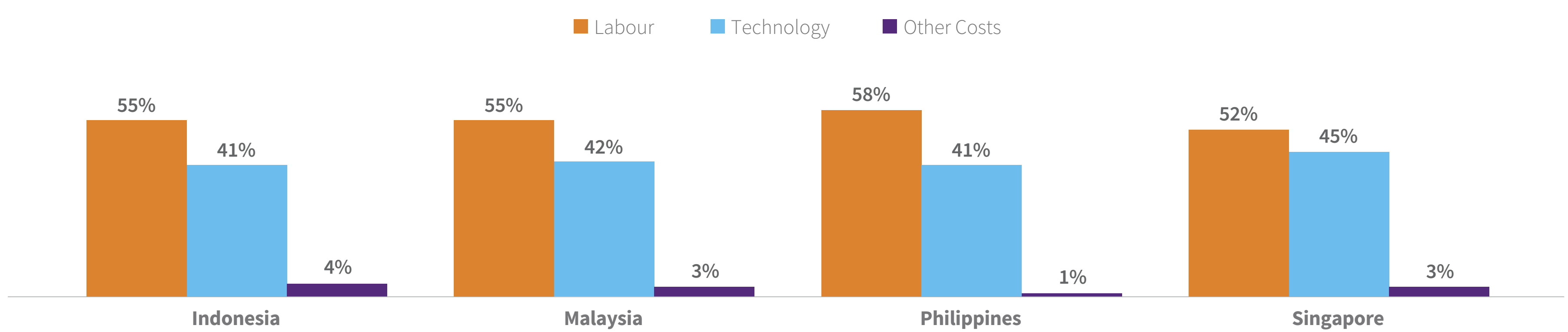
As mentioned, across APAC study countries, labour comprises a sizeable portion of overall AML spend.

Over half of AML spend in each country is based on human resources, spread similarly across KYC Program, suspicious activity/transaction monitoring, investigations and compliance management activities.

Distribution of AML Compliance Costs by Compliance Activity

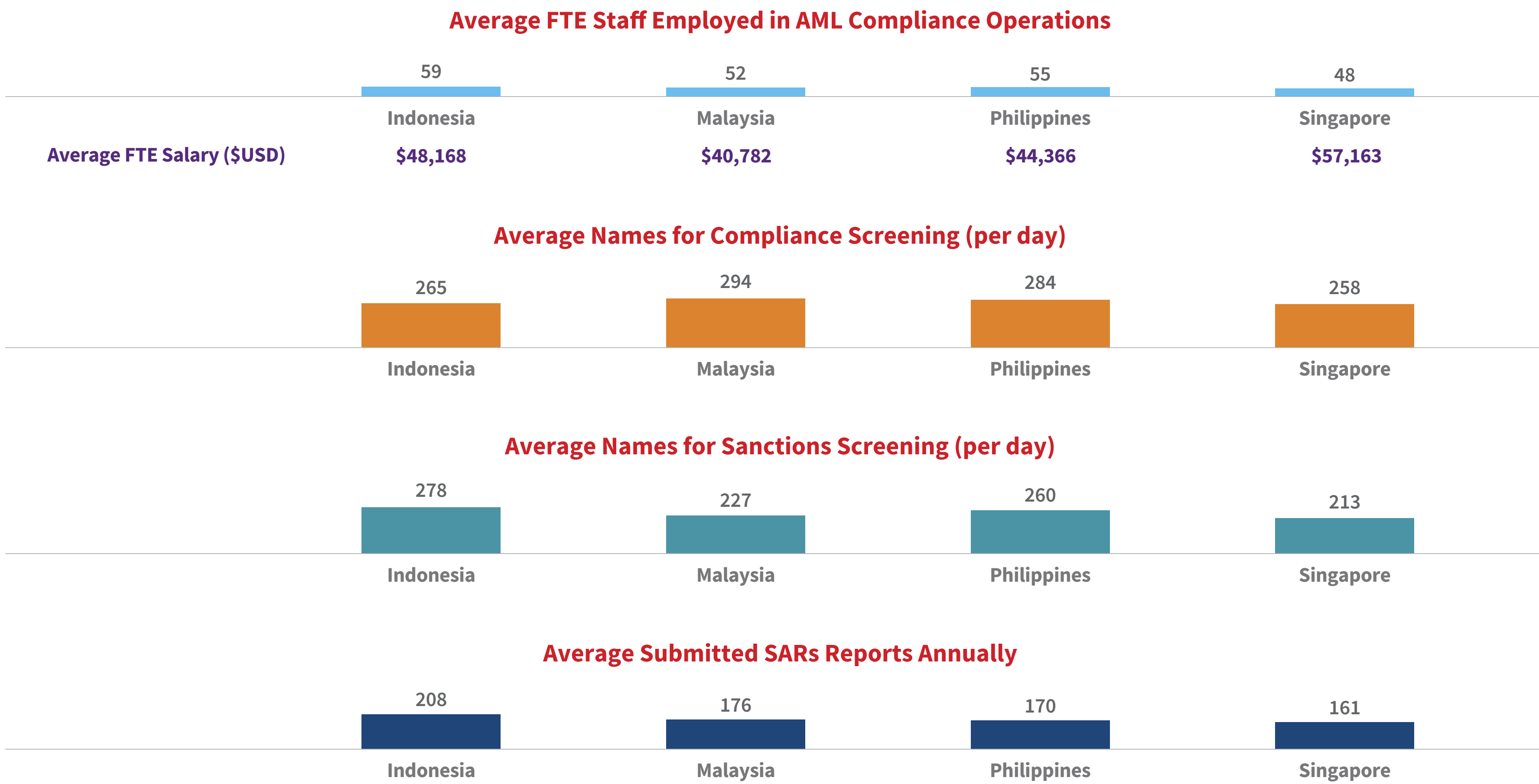


Distribution of AML Compliance Costs by Labor & Technology



Financial institutions across the study countries are handling high volumes of screening per day.

FTE salaries are higher, on average, in Singapore and Indonesia – which also have higher reported annual compliance spend.

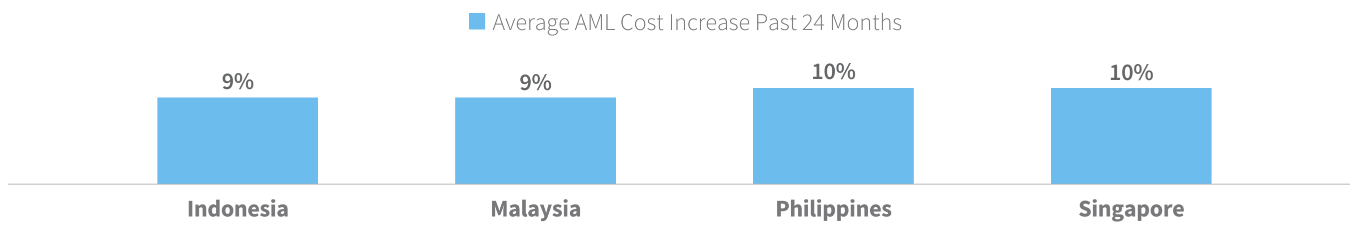


Overall AML compliance costs have reportedly increased by up to 10% in the past 24 months.

AML and sanctions compliance costs are expected to rise over the next year, at levels similar to increases since 2017.

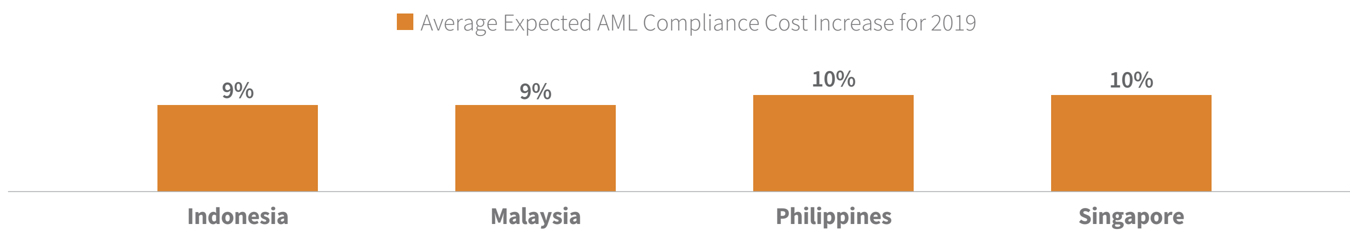
Cost of OVERALL AML Compliance Changes Past 24 Months

91% to 95% across countries indicated that costs have increased during the past 24 months

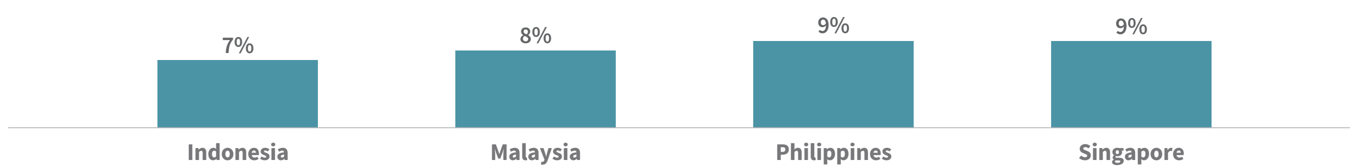


Expected Average Cost Increases for 2019

87% to 93% across countries expect costs to increase in 2019



Average Expected Sanctions Cost Increase for...



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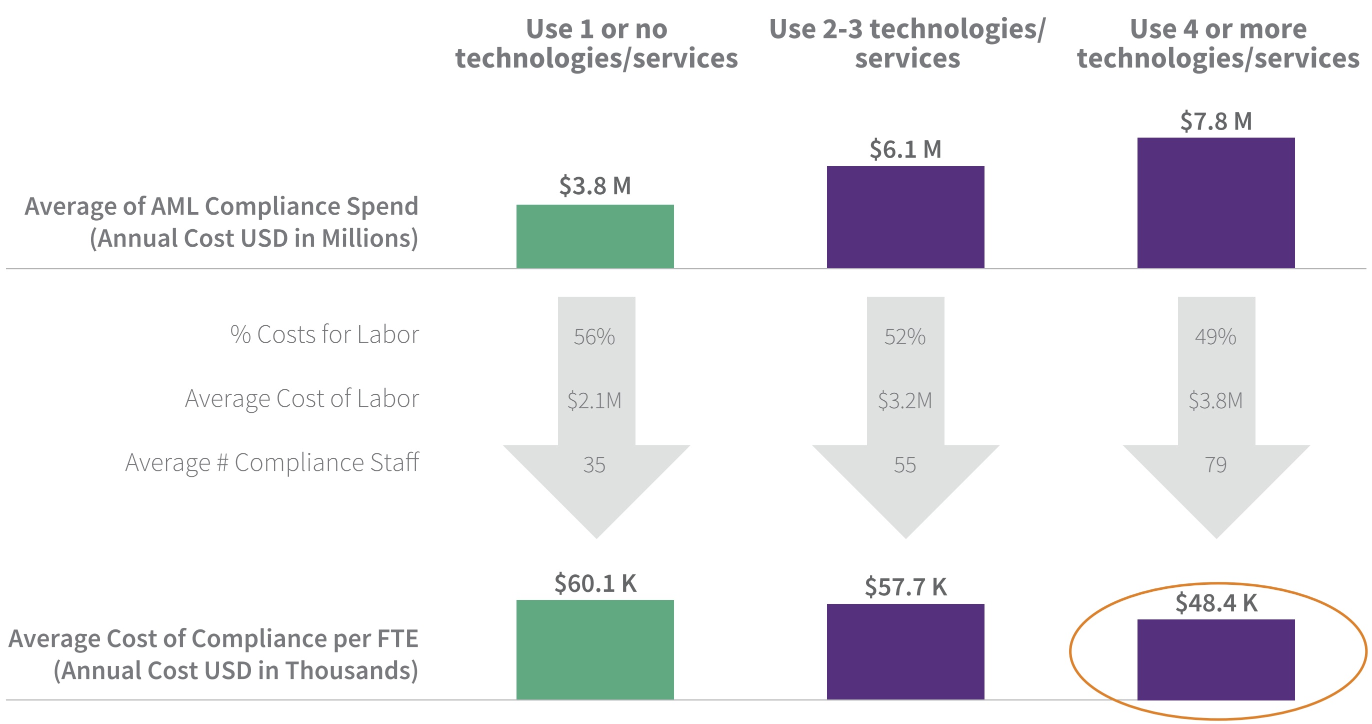
The use of technology can reduce the cost of compliance per FTE.

By adding more technology as compliance workforces grow, financial firms are actually decreasing the labour-related cost of compliance per FTE, as well as the opportunity costs associated with on-boarding friction and lost business.

Keeping FTE costs lower is essential to profitability, since labour tends to account for significant increased expenses year-over-year.

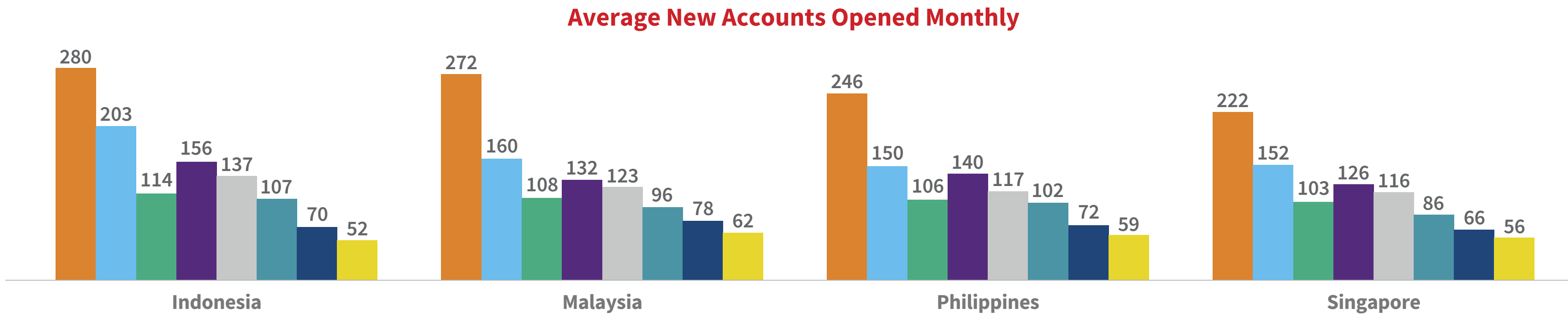


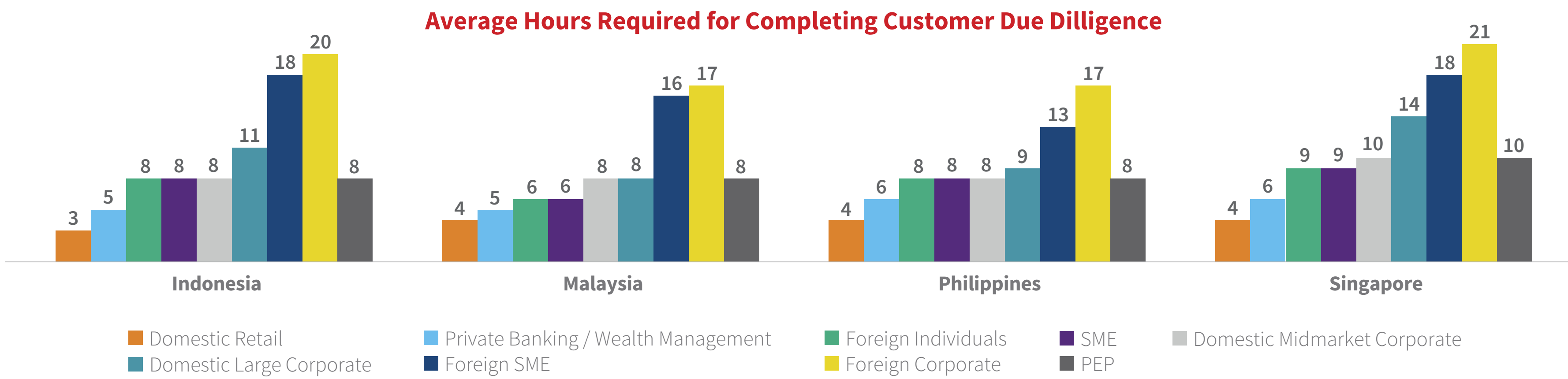
* Includes only those new technologies tested in this research

Across APAC study markets, there is an 80/20 rule with due diligence. Business accounts take more CDD time yet represent fewer monthly openings.

Foreign SME and corporate accounts take the longest to complete due diligence efforts.

Compliance technology can help to reduce effort and time with this activity, as shown on the following slide.

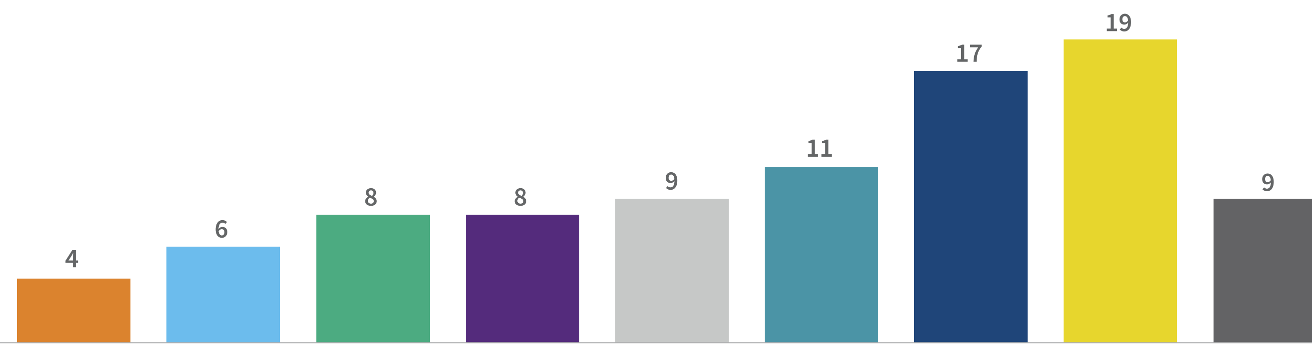




The use of these 4 or more compliance technologies/services allows APAC financial services firms realize some time efficiencies when conducting due diligence for new accounts.

Compliance technology particularly reduces the time taken to complete due diligence on foreign accounts, where it can be more challenging to determine beneficial ownership and sanctions risks.

Average Hours Required for Completing Customer Due Diligence (Business Accounts)



	Domestic Retail	Private Banking / Wealth Management	Foreign Individuals	SME	Domestic Midmarket Corporate	Domestic Large Corporate	Foreign SME	Foreign Corporate	PEPs
Average Hours Required for Completing Customer Due Diligence	4	6	8	8	9	11	17	19	9
Use 1 or no compliance technologies/services	4	6	8	9	10	13	20	22	9
Use 2-3 compliance technologies/services	4	5	8	7	8	9	15	18	8
Use 4 or more compliance technologies/services	3	5	7	7	7	8	12	13	7

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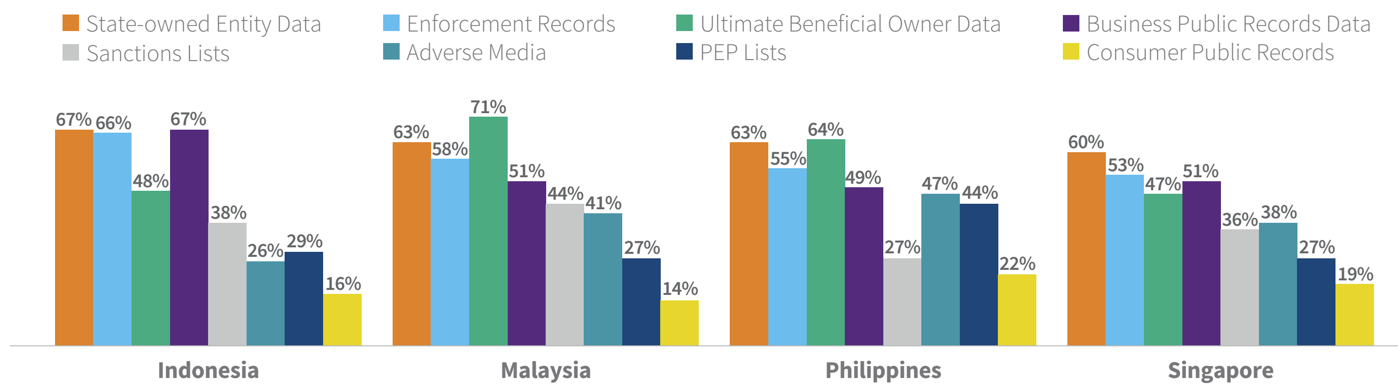
A variety of sources are screened against for customer due diligence, with state-owned entity data, enforcement records, and ultimate beneficial owner data being most common.

KYC due diligence alerts are cleared somewhat more quickly than other types, ranging from 3-5 hours to resolve. Other alerts require an average of 5-9 hours.

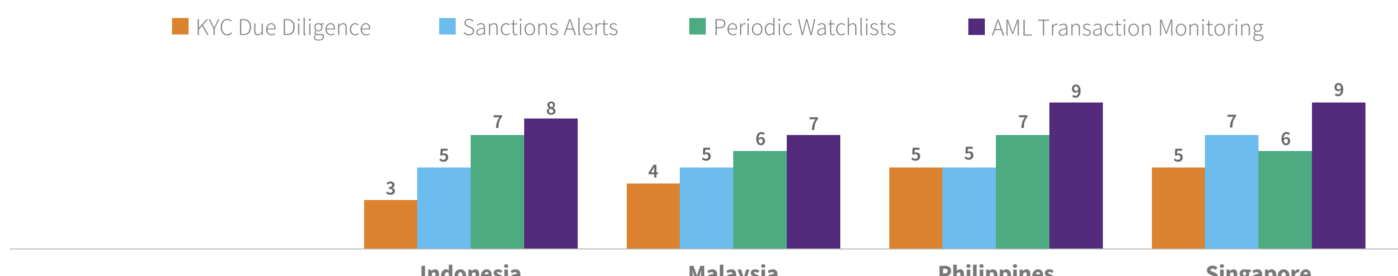
A majority expect alert volumes to grow in 2019, by an average of 9.4%-11.7%.

Sources Used to Screen Against for Customer Due Diligence

84% to 100% across countries indicated the sources take a similar amount of time to screen against



Average Hours to Clear the Following Types of Alerts



	Indonesia	Malaysia	Philippines	Singapore
% Who Expect Alert Volumes to Increase in 2019	78%	78%	84%	70%
Average Expected Increase	11.7%	11.6%	9.4%	10.5%

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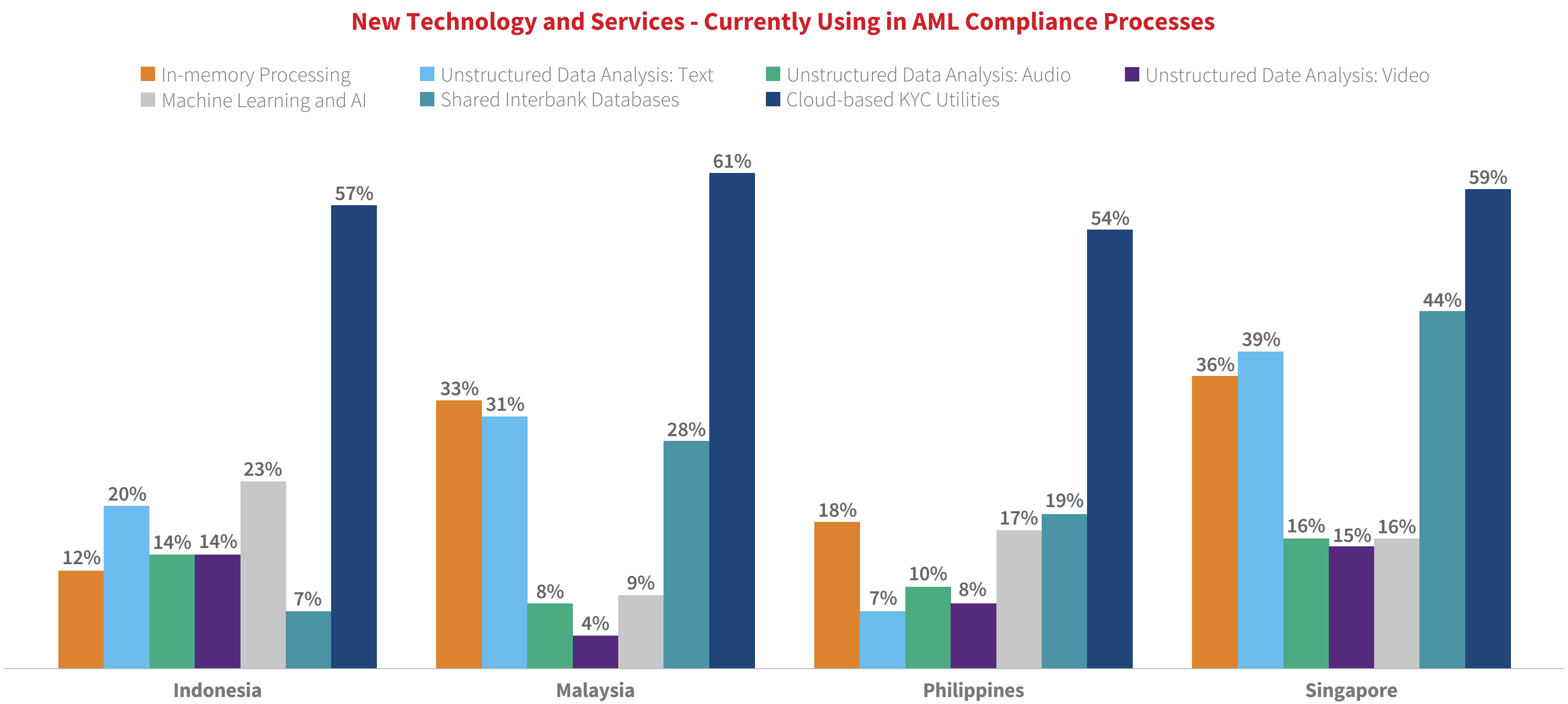
Well over half, across APAC study countries, reported current usage of cloud-based KYC utilities in their AML compliance processes.

Unstructured text analysis and in-memory processing are also commonly used in Singapore and Malaysia.

Use of other newer technologies and services is fairly limited for Indonesia and the Philippines.



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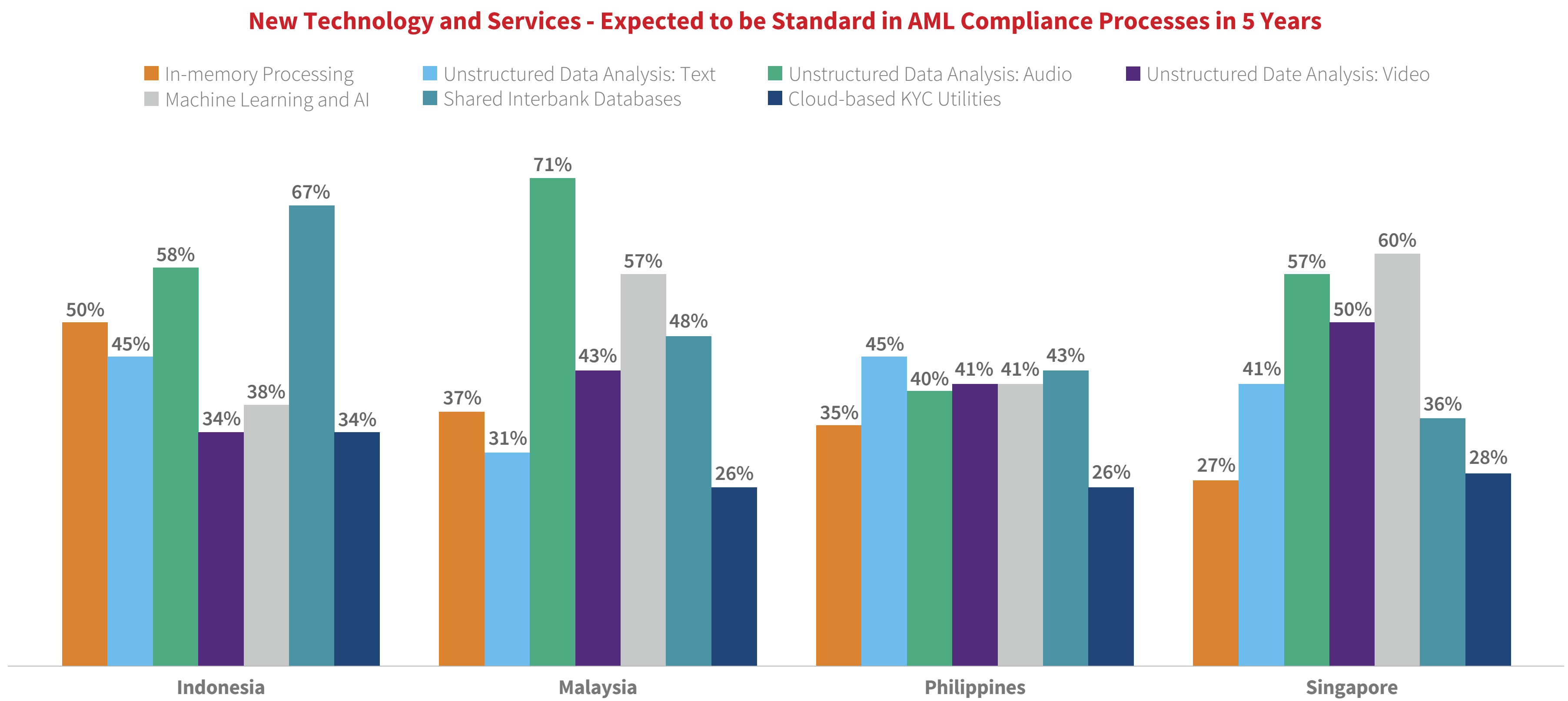
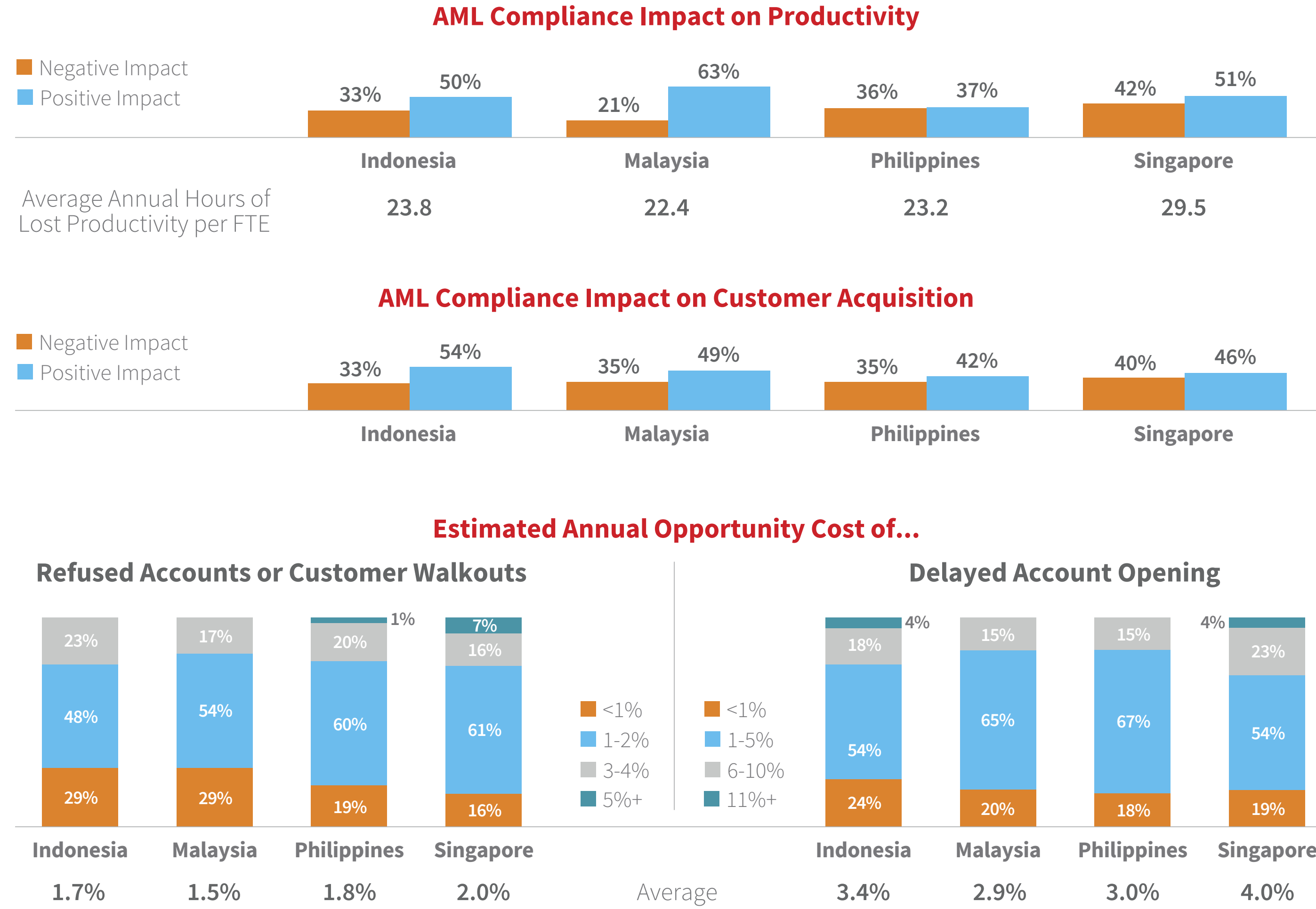
Unstructured audio analysis, machine learning/AI, and shared interbank databases are expected to become more prevalent in the next 5 years in most study countries.



AML compliance is viewed to have more of a positive impact on productivity in Malaysia and Indonesia, but is mixed in the Philippines and Singapore.

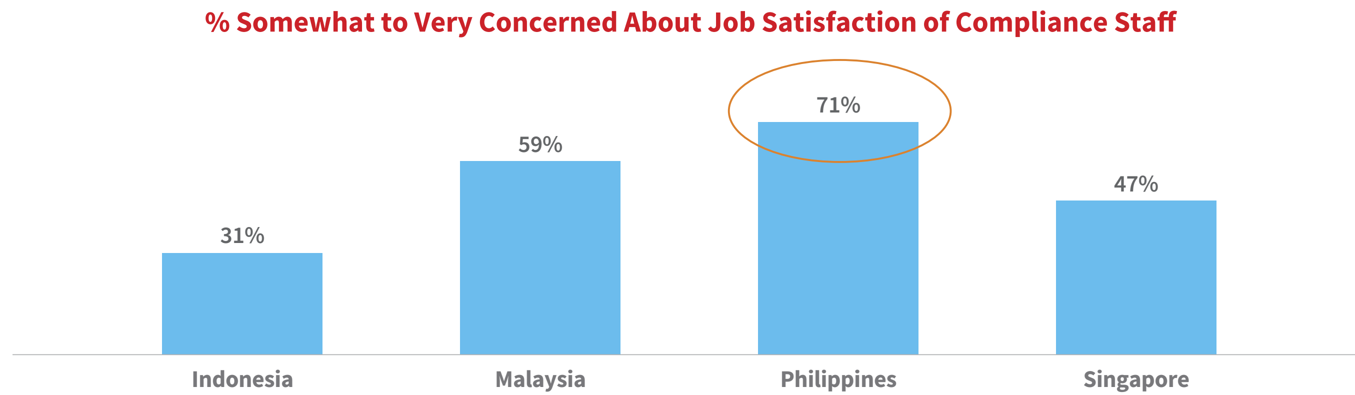
AML compliance is also perceived to have a more positive impact on customer acquisition in Indonesia, but is mixed for the other study countries.

The annual opportunity costs of delayed account openings due to AML compliance are relatively low, ranging from 2.9%-4% of new account applications. Estimated opportunity costs are even lower for refused accounts/walkouts, ranging from 1.6%-2.0%.



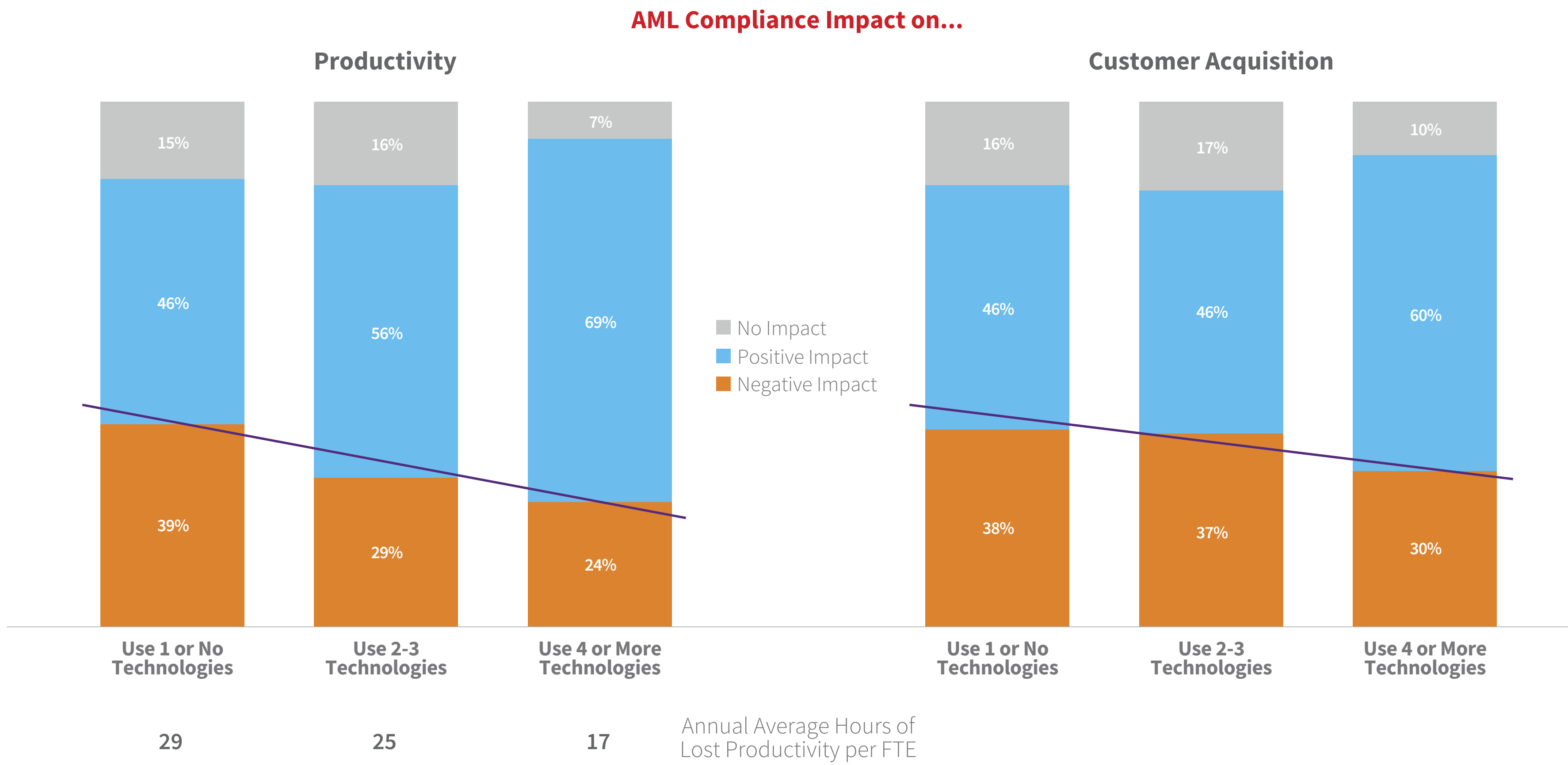
Not surprisingly, Philippine FIs are particularly concerned about compliance staff job satisfaction.

As shown later, this could be the impact that non-bank payment providers / systems are having on those firms. Philippine FIs were directionally more likely to mentioned expansion of operations screening hours along with challenges of determining beneficial ownership while dealing with more complex payment chains as negative impacts from these providers. Further, Philippine firms mentioned overall challenges with identifying PEPs and handling sanctions screening than most others.



Financial firms that use more technologies/services are less likely to feel negative impacts of AML compliance on productivity and customer acquisition.

And even those firms experiencing lost productivity lose fewer hours than those using fewer technologies/ services.



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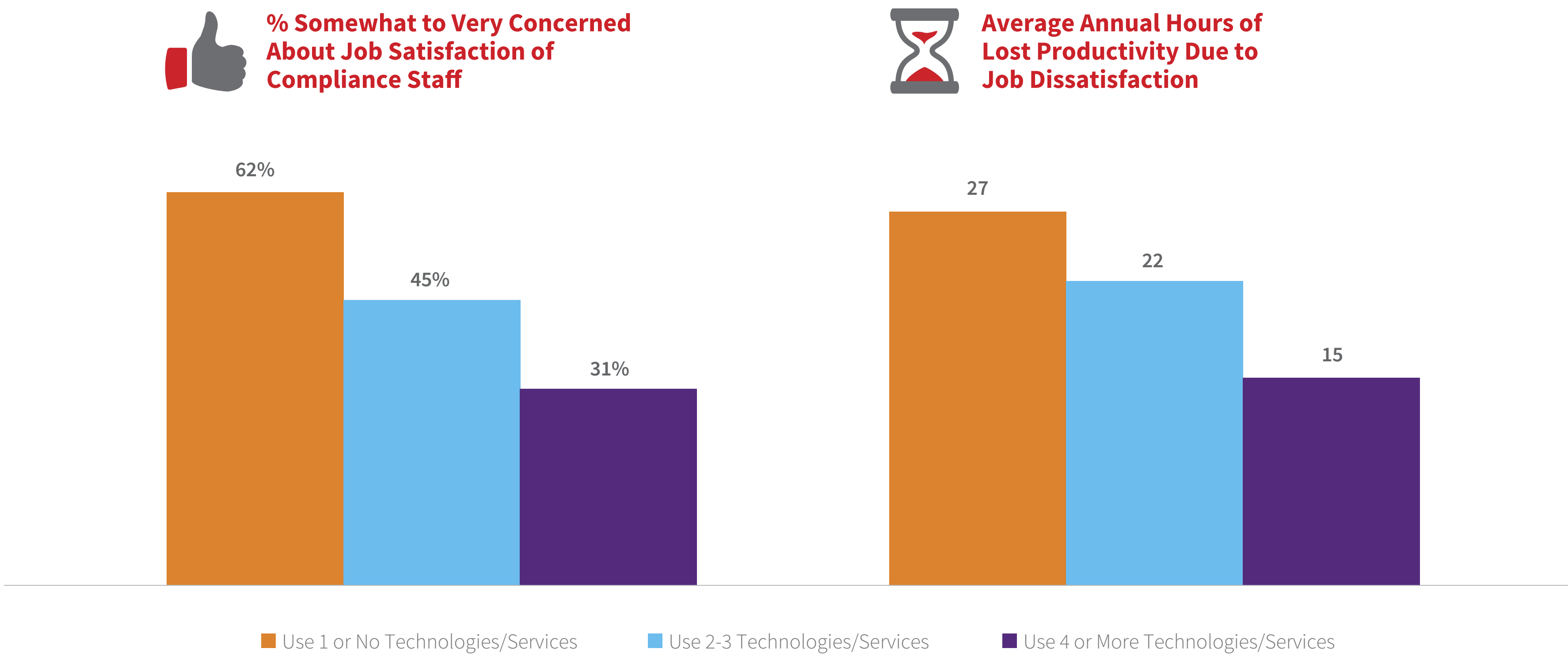
Being that FTEs are working more efficiently, there is less concern about job dissatisfaction and fewer hours of lost productivity related to this in firms using 4 or more technologies/services.

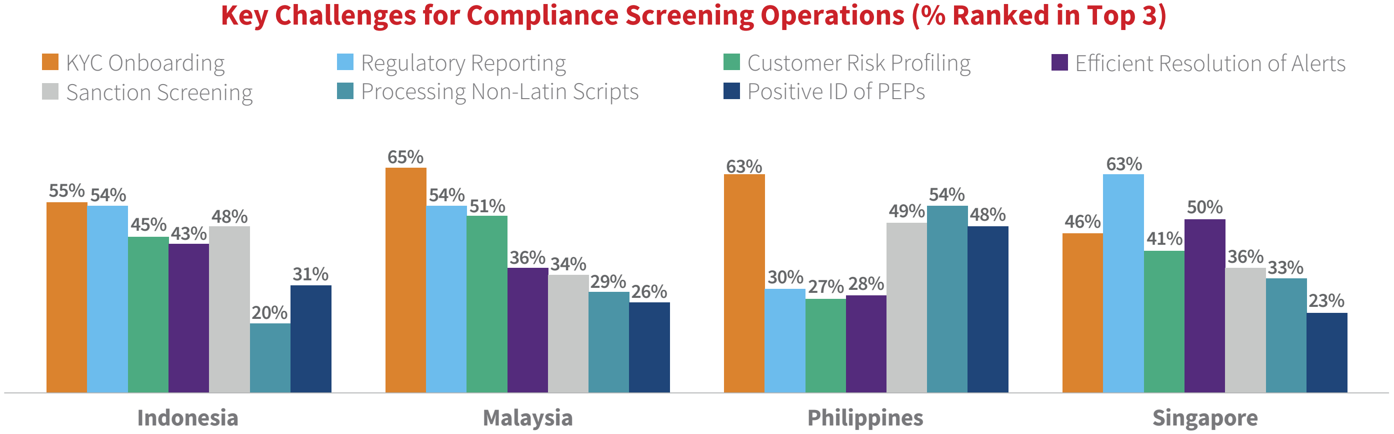


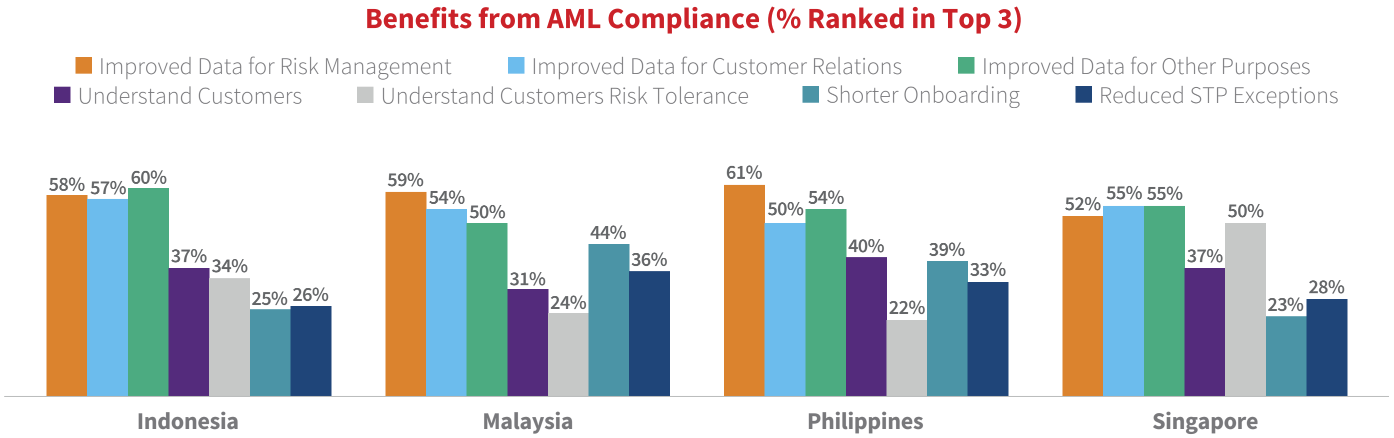
KYC onboarding and regulatory reporting are key challenges for compliance screening operations.

Processing non-Latin scripts and positive identification of PEPs are more challenging for companies in the Philippines than in other study countries.

Key perceived benefits of AML compliance include improved data for risk management, for customer relations, and for other business purposes.

Understanding customer risk tolerance is also a benefit for Singapore companies.



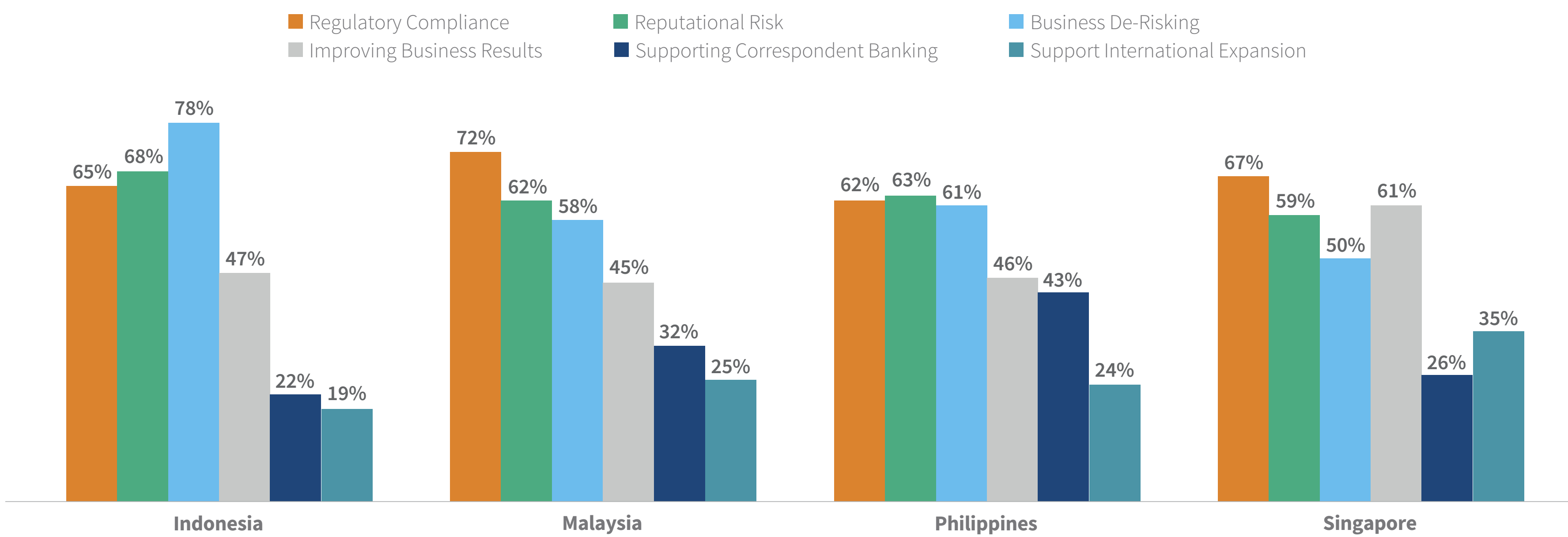


Regulatory compliance, reputational risk, and business de-risking are key drivers of AML initiatives across study countries.

De-risking is the top driver in Indonesia, and is directionally higher than other APAC study countries. Given the sizeable AML risk in its financial sector, this tends to make sense, particularly given that nearly half of firms indicated sanctions screening as a key AML compliance challenge.

Regulatory compliance and reputational risk are similarly ranked as top drivers across markets. Improving business results is a top driver for FIs in Singapore more so than in other markets; it's important to keep in mind that better KYC data and processes help not only compliance, but other functional areas as well (i.e., knowing more about customers can help marketing new products, sell different services).

Drivers of AML Initiatives in Respondents' Organizations (% Ranked in Top 3)



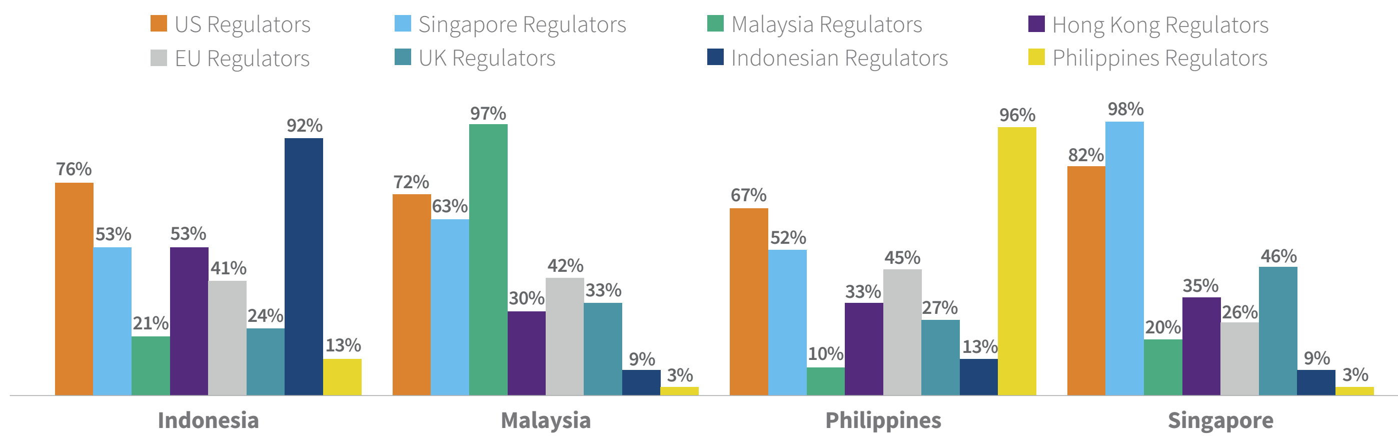
Not surprisingly, country-specific regulators have the most impact on regulatory compliance. But US regulators also have substantial impact across APAC study countries.

UK regulators also have some impact in Singapore, as do EU regulators in Indonesia, Malaysia, and the Philippines.

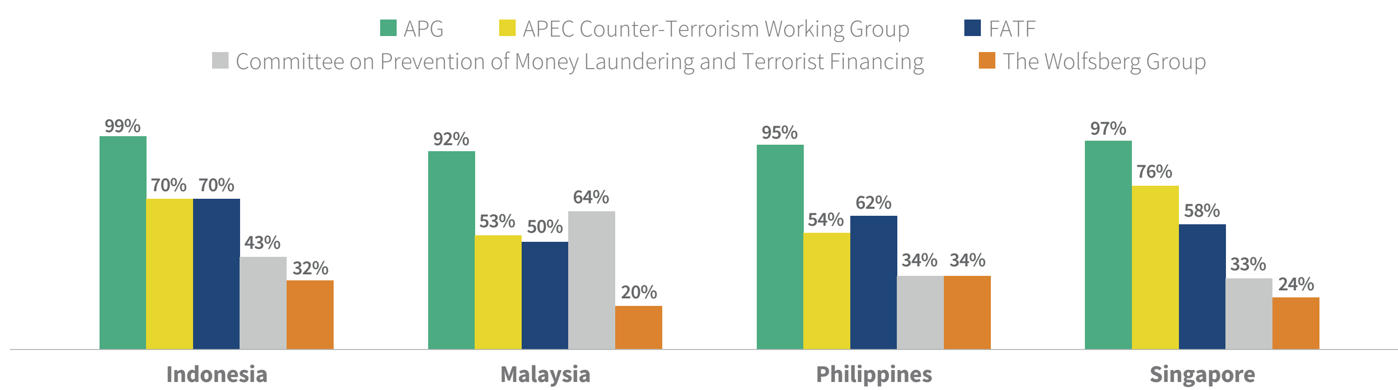
The Asia-Pacific Group (APG) on Money Laundering leads among organisations cited as having impact on regulatory compliance, followed by the APEC Counter-Terrorism Working Group and the Financial Action Task Force (FATF).

The Committee on Prevention of Money Laundering an Terrorist Financing is also influential in Malaysia.

Regulators Having Greatest Impact on Regulatory Compliance (Ranked in Top 5)



Organisations Having Greatest Impact on Regulatory Compliance (Ranked in Top 5)

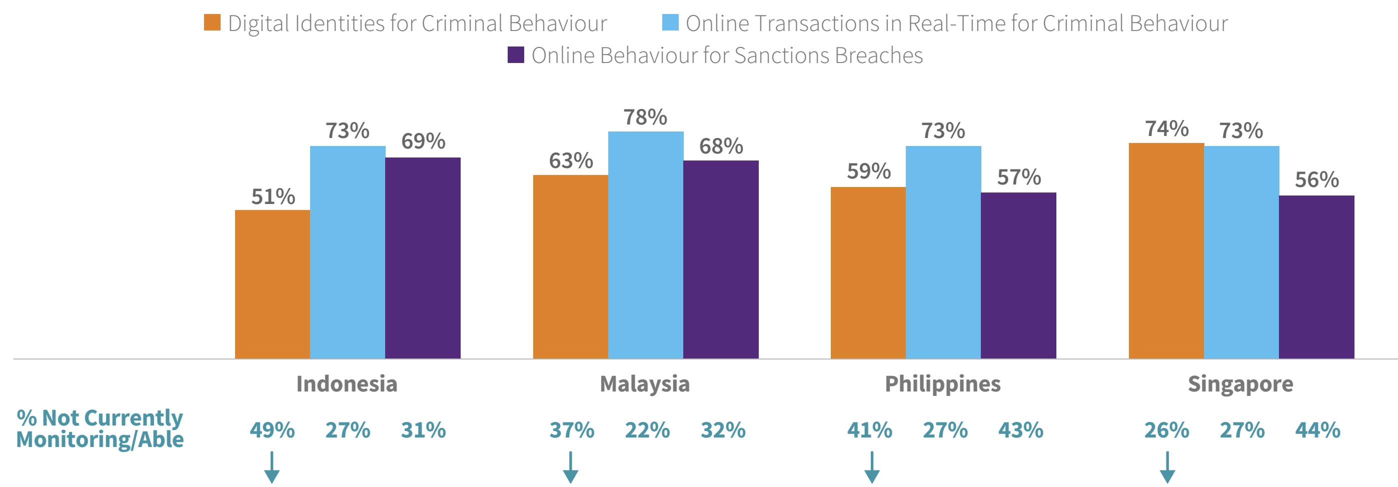


Many are currently monitoring digital identities for criminal behaviour, particularly in Singapore.

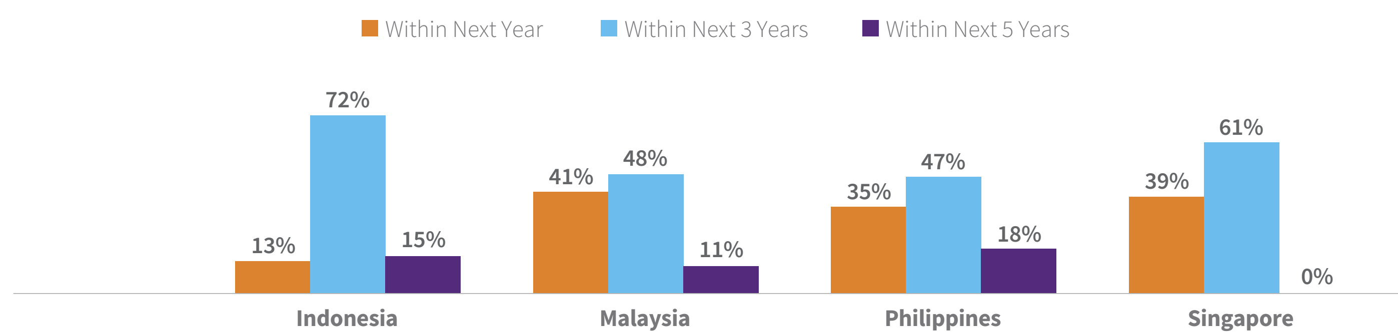
Many in Indonesia and Malaysia are able to monitor online transactions in real-time for criminal behaviour and online behaviour for sanctions breaches. This is somewhat less common in the Philippines and Singapore.

A large majority of those not currently monitoring digital identities will start doing so within the next 3 years.

% Currently Monitoring/Able to Monitor...



Timeframe for Beginning to Monitor Digital Identities



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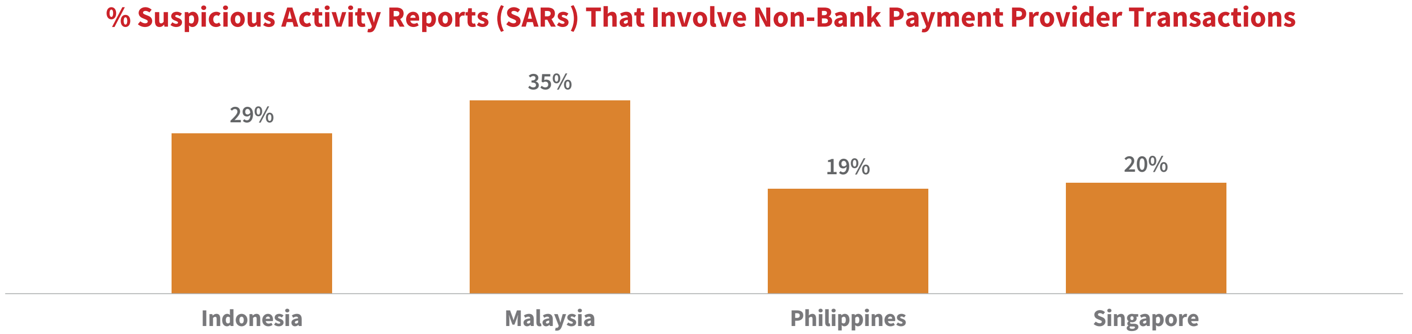
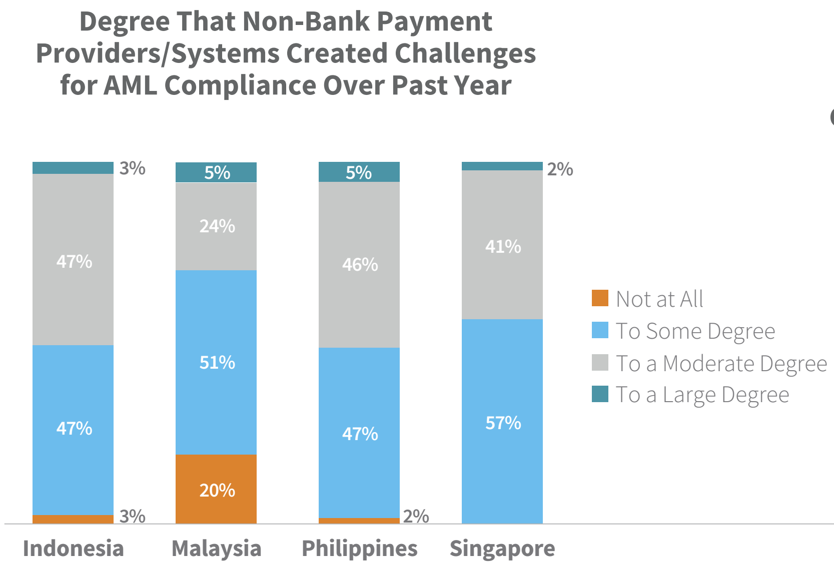
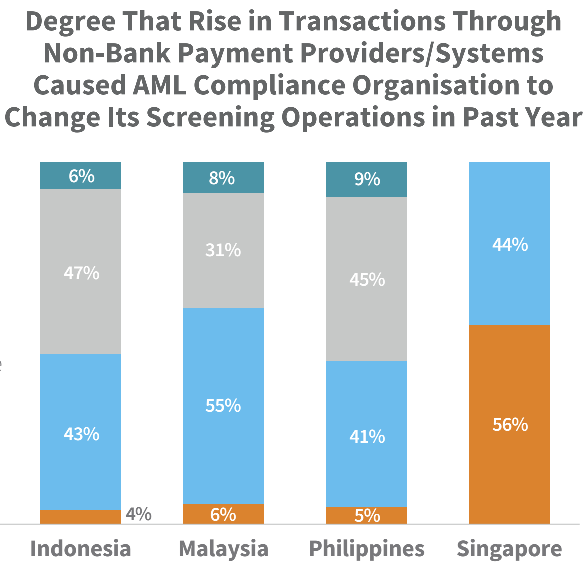
Indonesia and Malaysia experience more SARs that involve non-bank payment providers than other study countries.

Non-bank payment providers created challenges for AML compliance over the past year.

Additionally, the rise in non-bank transactions has cause compliance organisations to change their screening operations to at least some degree in the past year.





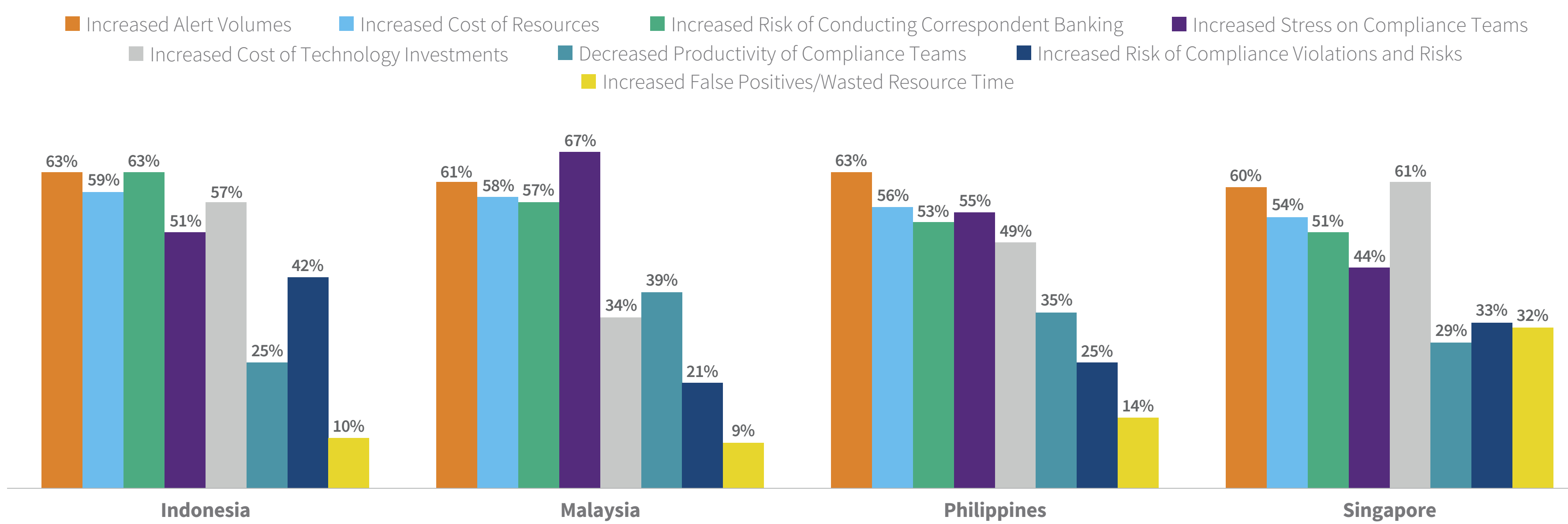


The impacts of non-bank payment providers on compliance operations are similar across country, with increased alert volumes, increased resource costs, and increased risk of conducting correspondent banking among the most mentioned.

Increased cost of technology is somewhat more of an impact outside of Malaysia, while increased risk of compliance violations are somewhat more cited in Indonesia. Increased false positives/wasted time has more of an impact among Singapore organisations.

Malaysian compliance teams may be experiencing more stress as a result of non-bank payment provider/system challenges and SARs. Indonesian and Singapore FIs, which report a higher average annual compliance spend, cite increased cost of technology investments as an impact from the growth of these providers/systems.

Impacts of Non-Bank Payment Providers/Systems on Organisation's AML Compliance Processes



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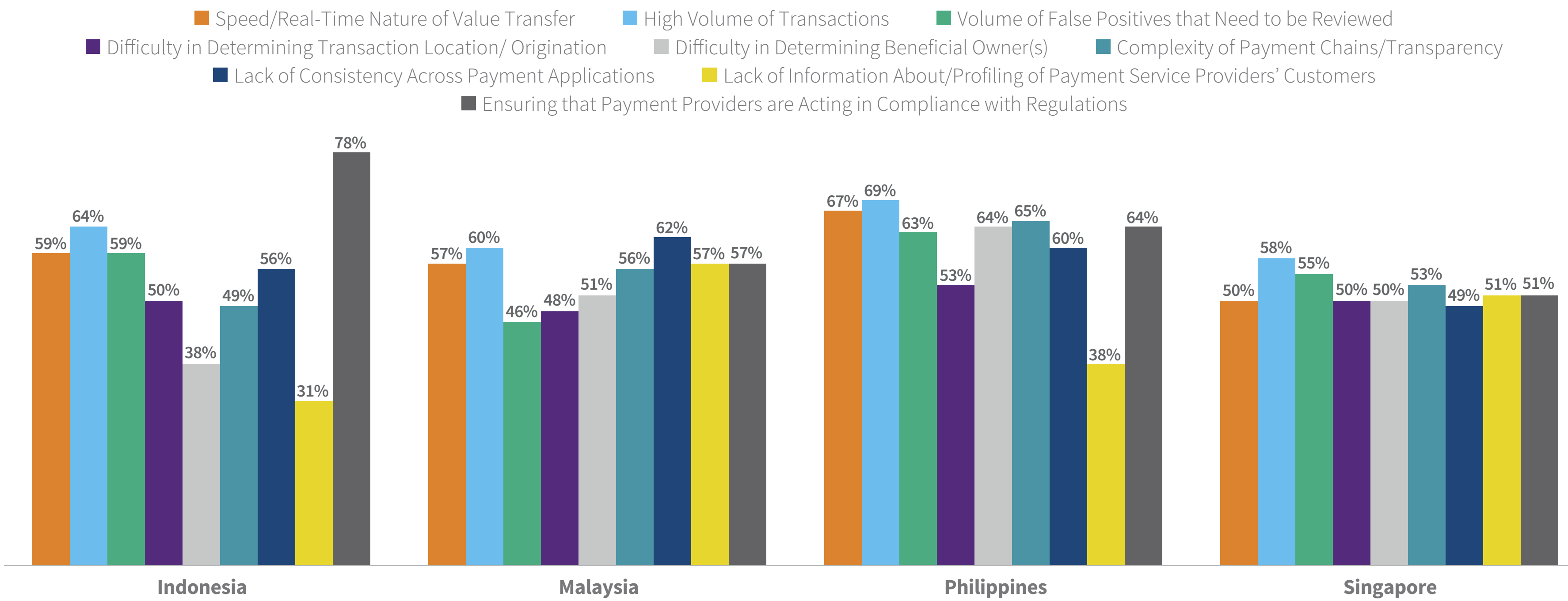
Various and similar challenges emerge across countries as the results of screening non-bank transactions.

Determining beneficial owners and lack of information about/profiling of payment providers' customers have been somewhat less challenging for organisations in Indonesia, while ensuring that payment providers are acting in compliance with regulations has been more.

Indonesian and Philippine FIs directionally report false positive reviews more than others; Philippine firms also mention difficulty with determining beneficial owners and dealing with complex payment chains more than others.

Degree Following Have Been Challenging to AML Compliance Operations When Screening Non-Bank Transactions (% Moderate/Large Degree)

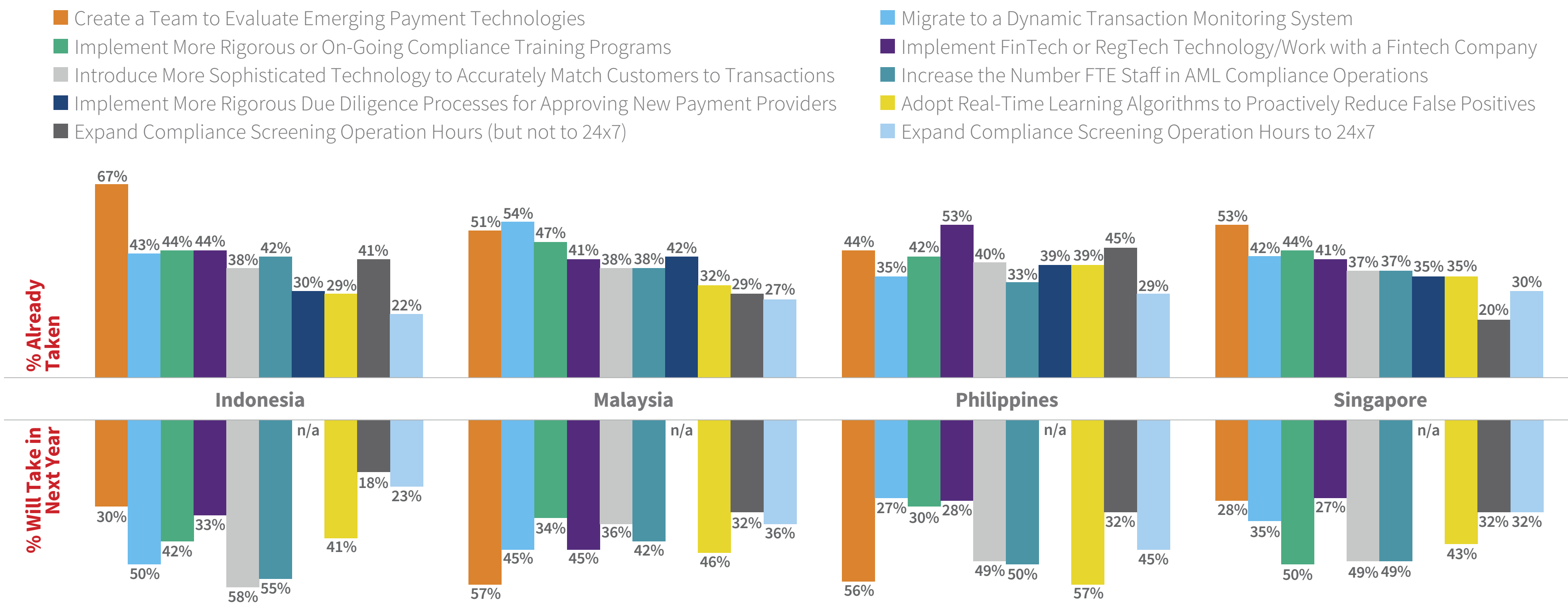


Various and similar actions have already been taken across countries to address challenges related to non-bank transactions.

These include creating a team to evaluate emerging payment technologies, migrating to a dynamic monitoring system, implementing more rigorous/on-going training, and implementing/working with FinTech/RegTech technology/companies. Indonesian and Philippine firms have also expanded screening operations hours more so than others, though not necessarily increase the number of staff to do so.

Though these actions have already been taken, some organisations will continue to focus on these areas in the next year. Other areas of focus include introducing more sophisticated technology and increasing FTE staff numbers.

Actions AML Compliance Organization Has Already Taken/Will Take to Address Challenges With Non-Bank Transactions



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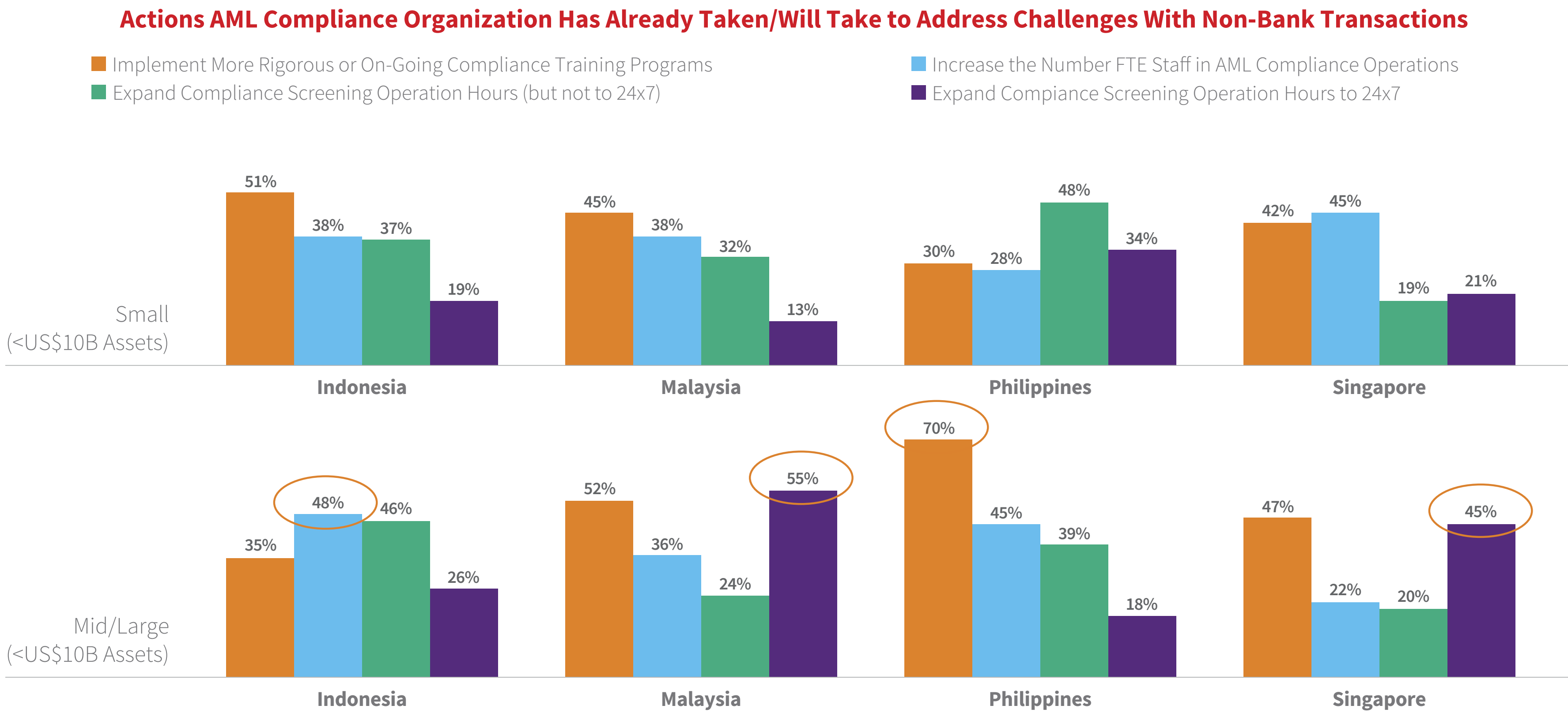
A number of mid/large FIs have taken labour-related steps to address risks and challenges posed by non-bank payment providers/systems.

The specific actions vary some by country, though involve either hiring more FTE, increasing training or expanding screening operations hours.

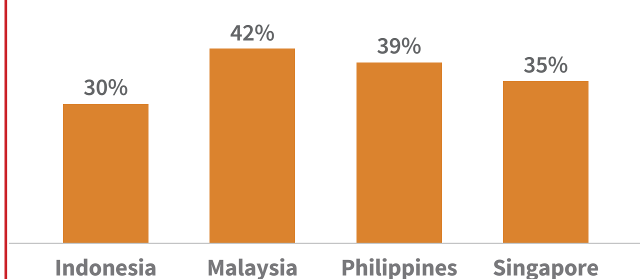


Few FIs have implemented more rigorous due diligence processes for approving new payment providers, even though there are concerns.

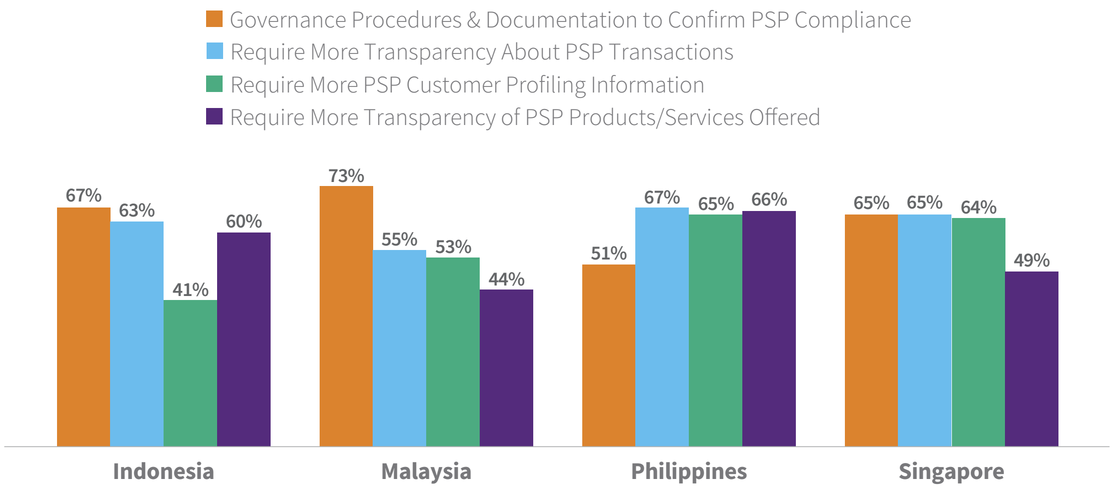
This is particularly limited in Indonesia, which has significant AML risk related to terrorist financing, a sizeable representation of non-bank payment provider transactions among annual SARs and where financial institutions are keen on de-risking given concerns that these providers create added risk for compliance violations. Those that have added more rigor to the approval process have required more transactional and product/service transparency, as well as more governance and documentation to confirm PSP compliance.

And, less than half of Malaysian financial firms, which also have sizeable SARs related to non-bank payment providers, have implemented more rigor in their review process. Among those which have, governance procedures and documentation to confirm PSP compliance has been a new due diligence activity.

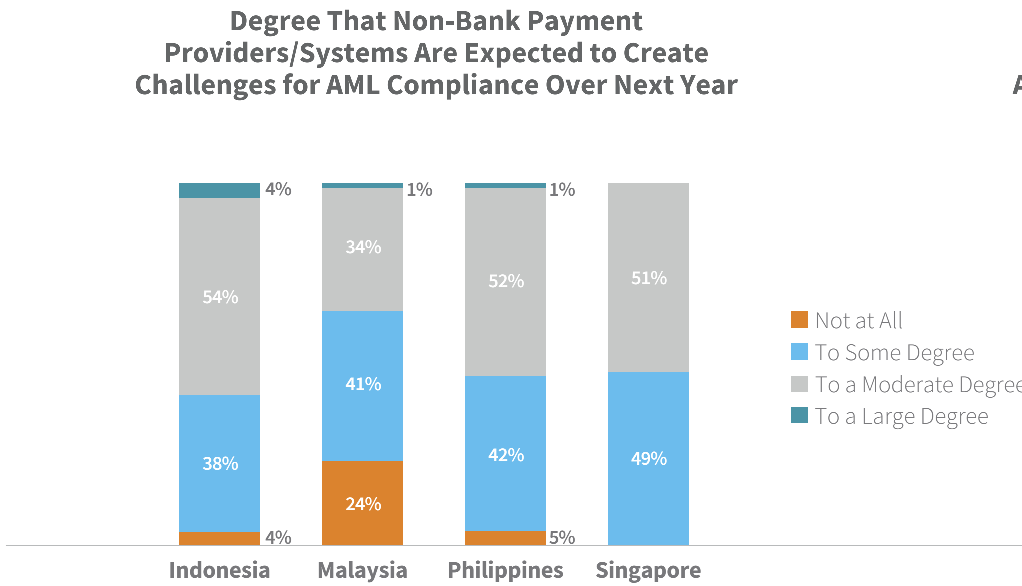
Implemented More Rigorous Due Diligence Processes for Approving New Payment Providers to Address Challenges With Non-Bank Transactions

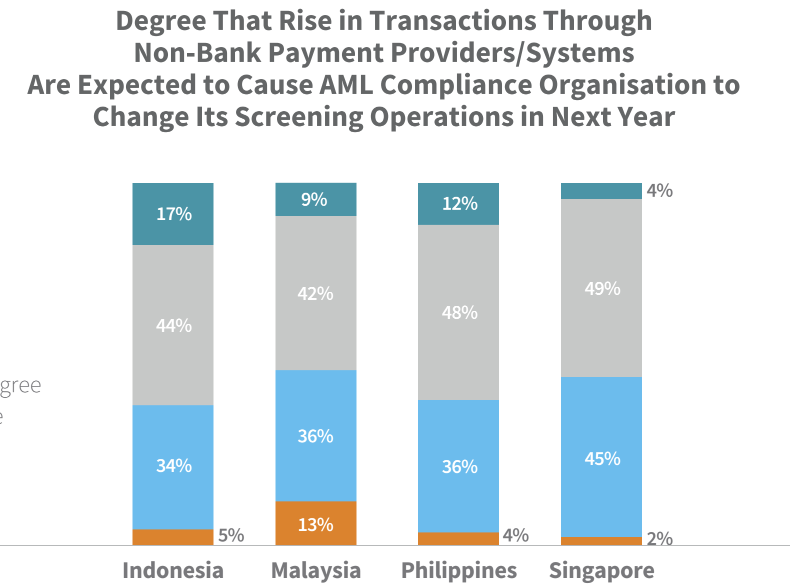


Steps Taken to Implement More Rigorous Due Diligence Processes for Approving New Payment Providers



Non-bank payment providers are expected to continue creating challenges for AML compliance that will require screening operations changes over the next year.





Implications

1. **Technology plays an important role** in effectively managing the impact of AML compliance on the business.

   » It's not just about managing the direct costs, but also the indirect and opportunity costs that can be harder to measure.

   » And, these opportunity costs are not just about lost prospects and future revenues associated with friction and delays at onboarding. Missing a holistic view with KYC adds the risk of letting "bad actors" in the door, thereby incurring hefty fines and reputational damage.

   » Having accurate data and highly capable solutions generates a degree of utility for not just compliance, but other functional areas as well. This includes business development and marketing; knowing more about customers can help inform the right products and services to position with customers.

2. **As compliance regulations grow in complexity and translate into more alert volumes, it will become increasingly difficult for APAC financial firms** to keep pace, manage false positives, and avoid non-compliance issues. A common reaction can be to add more human resources. However, this is not a profitable long-term solution.

   » The cost of human resources almost always trends upward. At some point, firms will reach a point of diminishing returns.

   » The rise in human resource costs can rise sharply where financial firms feel the need for more skilled resources to address more complex compliance decisions. More demand increases salary demands, especially if there is a limited universe of skilled resources that firms are fighting for.

Implications (cont.)

- Further, without the support of expanded data sources, bad data can lead to bad decisions regardless of the number of human resources applied to a case.

3 **It is understood that financial executives, who face personal liability for non-compliance, can be wary of foregoing human input with these decisions.** But technology does not need to replace human involvement; it can augment it to improve compliance processes and reduce the need for bringing on more resources (while keeping those you have) – thus "future proofing" against significant cost increases over the long term.

- Using solutions to help compliance teams analyse existing data, have access to other external information, and make decisions from a more holistic view of the customer can reduce on-boarding times, decrease remediation costs, lessen processing times, increase throughput (without hiring more people) and create a more effective means of preventing financial crime over the long term.

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