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# COVID-19 IMPACT ON KYC

May 2020 - Marc Hartkamp

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## INTRODUCTION

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This opinion piece is a follow on to our recently published paper about KYC. Within this paper we identify and discuss some of the possible changes to KYC due to the current COVID-19 crisis; and the many potential challenges and changes in the financial system and in society that are relevant to the KYC process.

The opinions expressed are those of the CubeMatch Benelux Regulatory and Compliance team.



- **IMPLICATIONS FOR TRAVEL & WORKING FROM HOME**

COVID-19 has had an unforeseen impact on global travel and the way people work. Due to social distancing face to face meetings and screenings will be less commonplace, and that brings an added impetus to how we can digitalise all data and screen clients and transactions while meeting all other privacy regulations (e.g. GDPR). Some banks have already opted for “virtual due diligence inspections” for large retailers.

Privacy regulations not only impact clients but with working from home becoming the new norm, greater care needs to be taken to ensure data is safe and handled in a way that is compliant.

- **FINANCIAL STABILITY**

The accuracy of existing client investigation and risk categorisation may also be impacted due to the consequences of COVID-19 on the financial system and on the stability of some clients. Some supply chains may have been impacted and in certain cases this could mean that client stability has been degraded, resulting in some clients now posing a higher risk and thereby an effect on solvency.

The position of Ultimate Beneficial Owners may have changed due to possible bankruptcies, mergers, and acquisitions. As the identification of an UBO is a key aspect of KYC regulation, it becomes imperative that financial institutions are both accurate and fast in identifying any changes.

Issues of financial stability can also impact individuals, and again the current KYC data may no longer be accurate.

- **CHANGES IN BUSINESS**

With some limitations put on businesses by governments, certain businesses may be forced to diversify or change direction. If this occurs, then it will be important for financial institutions to react quickly and make the appropriate changes to note any effect on credit risk.



- **INCREASE IN URGENT REVIEWS**

The previous two points could result in financial institutions being forced to deal with a large number of urgent KYC reviews. This could be problematic for financial institutions already dealing with the pressure from regulators to rescreen clients. With resources that are possibly working at least part time at home on KYC, there is a need for a clear strategy on how to deal with these reviews.

- **INCREASE IN FINANCIAL ECONOMIC CRIMES AND IMPORTANCE OF AML**

Perhaps the most important aspect of KYC is the countering of financial economic crimes (FEC). Anti-Money Laundering (AML) and CFT (Countering the Financing of Terrorism) are key parts in the fight against FEC. KYC and AML are intricately linked and trends in both fields will impact each other.

Criminals often find new ways of committing crimes in times of change and/or crisis. Financial institutions and regulators need to find a way to deal with them appropriately. It is already becoming apparent that fraud is ramping up and that current detection systems may not afford adequate protections to deal with new criminal efforts. Multiple international agencies have warned of fraud and scams during this time.

This includes the FATF, a key international organisation against FEC. Apart from new forms of crime, the FATF has noted that inspections are difficult to carry out with respect to social distancing and lockdown laws, and note that governments are delaying "remedial actions" such as fining financial institutions for non-compliance with regulatory laws.

A key example of new era fraud is dishonestly requesting government aid from programs that have been set up to deal with the COVID-19 crisis. This has already occurred in several countries, and arrests have been made. Another issue is the evasion of financial sanctions. Humanitarian goods such as medical supplies are exempt from these sanctions. It is plausible that some sanctioned countries could try to exploit these exemptions. In addition to new forms of attempted fraud existing forms of fraud can also see a rise, an example of this as reported by the BBC has been perpetrated by some criminal organisations attempting to exploit the current situation.



The European Banking Authority (EBA) has recently highlighted an issue in the fight against money-laundering: dividend arbitrage schemes called Ex-cum and Cum-Cum trades. They want financial institutions to “take a holistic view of the risks highlighted by dividend arbitrage trading cases, [...] which may give rise to questions about the adequacy of financial institutions anti-money laundering systems”. They are working on changing their guidelines for AML/CFT by 2021. Together with the ongoing struggles posed by COVID-19 this calls for management to be on high alert. Machine learning and an alert and adaptable management will be required to combat this threat.

- **OUTDATED RULES?**

With businesses having to change the way they operate, changes to the financial system and to society, and with endeavours of criminals to carry out financial crimes both at a corporate and individual level, the rules that are key to the KYC process may not be sufficient. This can have the unintended consequence of showing false positives or that new forms of suspect activity will go undetected. The entire system and collection of red flags may need reviewing.

As a consequence, business rules may need to be revisited, modified or new rules put in place. Additionally, the existing algorithms used in the KYC process and the alerts that come up to signify possible breaches of law may require adaptation.

- **THE FUTURE?**

While there is a demand for additional digital solutions and automation through machine learning and big data requiring significant change; there also needs to be an emphasis placed on knowledgeable staff, processes and systems.

While there have been lessons learned from recent setbacks and fines both in the Netherlands and further afield, we need to be alert to the trouble ahead.

There are more possible consequences to the COVID-19 pandemic and if you would like to discuss any of the information in this article please contact [marc.hartkamp@cubematch.com](mailto:marc.hartkamp@cubematch.com) or [benelux@cubematch.com](mailto:benelux@cubematch.com).

## KEY SOURCES

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