DueDil

Solving the challenges of KYB and in-life monitoring in the SME Sector

Introduction

As the UK economy begins to grow again after months of pandemic-related disruption, the small- and medium-sized enterprise (SME) sector will have a key role to play in driving its recovery.

At the start of 2020, there were six million SMEs in the UK, representing more than 99.9% of the total business population[1]. Together, these firms employed ~60% of the UK workforce and generated ~50% of UK private sector turnover. Wind forward to 2021 and the number of SMEs has grown further, fuelled by a surge of start-up activity across the UK and other global economies triggered by the pandemic[2].

According to research by DueDil, nearly 53% of UK SMEs are now less than five years old. To lock in economic growth in the wake of the pandemic, efforts to support and finance these fledgling UK enterprises have never been more vital.

Entrepreneurs are though, by their very nature, a nimble and resilient breed, pivoting their business models and adapting to each 'new normal' as it presented itself over the past 18 months. Understandably then, with change seemingly the only constant, businesses of all types have embraced digital transformation - from new online order taking and bookkeeping tools to web chat and digital servicing.

Higher levels of digital engagement are great news for the UK economy at large, but the shift from physical to virtual has also presented providers offering financial services (FS) with a number of interesting challenges, particularly when it comes to onboarding, monitoring and servicing their SME business clients.

Whether tending existing business relationships, helping clients to access financial services and products, or onboarding new customers in an efficient and fully compliant manner, many FS providers have been on a transformative journey of their own in recent times.

In this eBook we explore the specific challenges facing FS providers dealing with SMEs and the role of Know Your Business (KYB). KYB is a subset of traditional Know Your Customer (KYC) activity, dealing specifically with the checking, monitoring and vetting of business entities. We will look at the issues FS institutions face in managing the KYB process, and the growing importance of in-life monitoring as a way of ensuring providers stay informed about, and connected to, their current and future SME customers.

SMEs are a valuable and highly diverse sector

Of course, UK SMEs are not homogenous in nature. This is a highly diverse sector characterised by nuance. Across the UK economy, millions of individual businesses, each with their own unique circumstances, are engaging daily with distinct audiences through a wide array of bespoke offerings. However, you would not necessarily notice that fact judging by the way some financial institutions manage their SME customers.

Take business performance. The balance sheet, cash flow and P&L dynamics of SMEs are not uniform, and seasonal businesses in the tourism and agriculture trades will display markedly different trends over the course of a year when compared to sectors like legal services or transport. The latter are much less sensitive to time of year or the great British weather when it comes to revenue generation. Similarly, the days of judging the health of a client on the last 3- to 6-months of bank transactions are also numbered. In normal circumstances, such trends do indeed offer valuable clues about what's happening inside a business. And yet, if the pandemic has taught us anything, it's that normal rules of thumb like this can break down completely in the face of global events. In short, better data and methodologies are needed.

The needs of SMEs are also diverse. Different customers will want different things from their financial providers - for example, personalised services versus transactional convenience - at different times and at different stages of their business lifecycle. Being close to the customer, understanding where they are in their unique journey, and being able to meet their needs is crucially important in an increasingly competitive marketplace.

Bottom line then, blunt segmentation by turnover, location or industry sector can result in service providers missing much of what makes these enterprises successful. And, since it is the distinctness of their offerings that can mean the difference between expansion and failure for a small or medium-sized firm, this lack of definition can impact the ability of institutions to correctly assess the risk or credit worthiness of a particular business customer.

Indeed, because SMEs are perceived in some quarters as high risk investments with low returns, some institutions may choose not to engage with them at all. This would be a mistake, however, given the scale of the opportunity they present.

According to recent data published by the UK Parliament[3], UK private businesses generated a combined £4,347 billion of turnover in 2020. Of this, £1,954 billion, or 45% of total national business turnover, was contributed by SMEs with 0-250 employees. And, as the proportion of SMEs in the economy grows, so too will the proportion of economic value created.

Through innovations such as cloud computing and the proliferation of APIs and powerful analytics fuelled by so-called 'big data', the SME market is becoming increasingly accessible. Challengers such as Tide, Starling and OakNorth are providing services to this underserved sector and focusing on providing a differentiated, tailored UX to better meet customers' supercharged digital expectations. As a result, business banking has become one of the most dynamic growth areas in FinTech and, as the benefits of open banking become fully realised, is also a key battleground where incumbent banks and challengers will face off for the most profitable customers.

SMEs are struggling to access the financial services (and credit) they need

Against this backdrop, the pandemic has thrown up a number of challenges for SMEs, with finance being a key issue. According to the British Business Bank[4], almost half of UK SMEs sought external financial support during the course of the last year, compared to just 13% in 2019. Much of this was delivered through Government-backed coronavirus lending schemes, and by the end of 2020 the total level of bank debt for the UK SME sector had reached £213bn. While banks have been relieved to see a much anticipated crystallisation of bad debt fail to materialise (thanks in large part to the help of such schemes) we are by no means out of the woods. Going forward, financial institutions must maintain a close watch on the risk positions of their customers.

Making this task more complex is the fact that the pandemic has also significantly changed how businesses behave. Adjusting to multiple lockdowns and the different trading patterns they entail has forced institutions to refresh their ideas of what a 'normal' risk profile for a small- or medium-sized client should look like. Leading firms have therefore turned to deeper data and more active, ongoing monitoring to generate the more granular view of their customers they need to manage risk and serve them in the best way.

Introducing KYB and in-life monitoring for SMEs

At DueDil, we know the importance of helping our clients to distinguish between Know Your Customer (KYC) and Know Your Business (KYB). KYC describes the necessary checks that are performed before doing business with an entity, be they an individual or company. These checks are a critical part of the compliance process driven by anti-money laundering (AML) regulations and the need to prevent fraud.

KYB is part of the overall KYC process, and focuses on checking the details of corporate entities. Financial institutions must ensure that they are doing business with valid firms that are legally incorporated and registered with the relevant authorities. In the UK, this would be Companies House. However, criminals will often use complex corporate structures and layers of shell companies to hide money laundering activity. Consequently, developing a robust method for tracking and understanding these structures, as well as the legitimacy of the people who control them (Persons of Significant Control, or PSCs) and who ultimately benefits financially from their activities (Ultimate Beneficial Owners, or UBOs) is mission critical.

For many years, KYB has been a scheduled activity, something that financial institutions have performed at the onboarding stage and at specific, defined periods during the relationship with their SME clients. However, leading financial institutions have realised they should really be thinking about KYB as an ongoing process consisting of three key elements - onboarding, risk assessment and in-life monitoring.

For financial institutions to formulate an accurate, dynamic picture of SME customer risk, it is much better for them to continually monitor their circumstances. If the information held about a company changes - for example, the number of employees grows or it pivots into a different industry sector - that can have a fundamental impact on the risk profile of that customer.

Like the broader KYB process of which it is part, ongoing monitoring is typically performed on a periodic basis, the frequency of which will be determined by the compliance risk of that customer. For example, the KYB information for an SME company deemed to be low risk will only be reviewed and refreshed every five years or so, depending on the institution.

As part of this periodic review process, new information is often requested directly from companies via their relationship managers (RMs). This puts pressure on RMs to request information from clients rather than focusing on more revenue-generative interactions, and injects unwanted friction into the customer journey. This can also be a highly manual process, taking up valuable resources, effort and time.

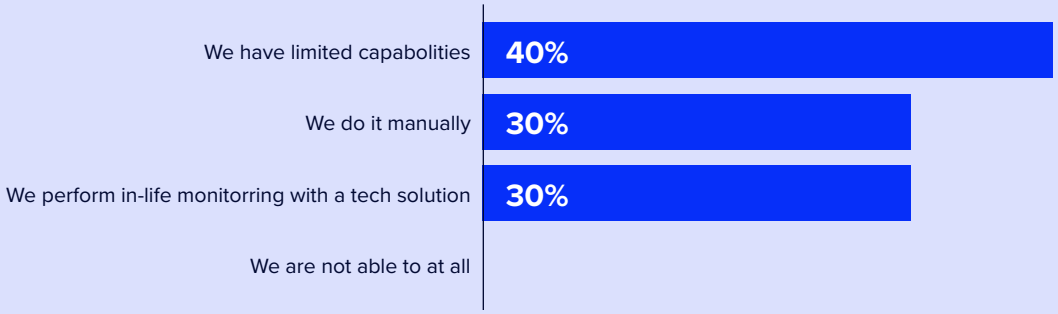
As we have seen, the SME sector is incredibly dynamic. On an average day, there are 12,000 changes to SME businesses in the UK and Ireland company registries. Clearly, saving up all these changes for a year or more and having to update all that information in a single effort is both costly and inefficient. Instead, firms should be striving to continuously track changes in the status and fortunes of their SME customers wherever they can. Key indicators would include updated employee numbers, shareholder and director details, business addresses and so on - all of which can materially impact the risk profile of an SME.

Recent history underlines why in-life KYB monitoring can be so important. In the midst of the disruption caused by the coronavirus pandemic, some financial institutions began to notice suspicious SME entities cropping up in their KYB checks. While appearing to be perfectly legitimate businesses on the surface, the people standing behind them were in fact assisting larger organised crime groups to commit fraud and other scams. In such cases, it proved difficult to distinguish legitimate businesses from those using a veneer of legitimacy to mask their true status as fronts for financial crime. Using more up-to-date information can definitely help financial institutions to make these determinations more easily.

During a recent webinar, we asked a range of financial institutions about their current in-life monitoring capabilities. Interestingly, only 30% of respondents reported using a technology-led solution for their in-life monitoring for SME customers. We believe this underlines the fact that there is still a considerable amount of work to be done, and challenges to overcome, in implementing these best practice solutions.

Challenges and benefits of in-life monitoring

How do you currently perform in-life monitoring for your SME customers?



In our discussions with our customers and industry experts, time and time again we hear that the biggest obstacles to achieving high performing in-life monitoring are the silos that operate within financial institutions. Sometimes, a siloed approach exists for good reason (e.g., the functional separation of retail banking from corporate banking mandated by the UK's post-crisis ring-fencing regime). However, in many cases silos are simply a function of prevailing operating models, leaving the teams involved in KYB and risk management disconnected from each other. Ironically, technology can sometimes also act to reinforce these silos, with different tools and systems used to manage KYB in areas such as compliance and credit risk management.

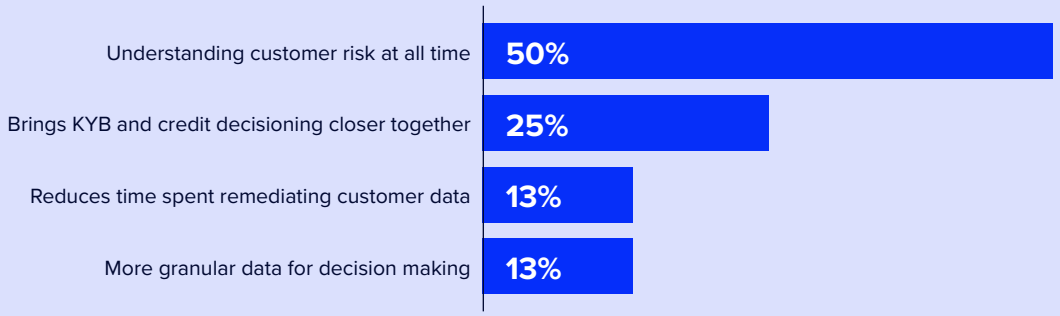
Regardless of their origins, silos can lead to highly fragmented processes that prevent firms from formulating a single view of the customer. This not only makes effective risk management more difficult to achieve, but also prevents firms seeing commercial opportunities with clients that might otherwise be revealed with a broader view of customer data.

In the future, we believe more financial institutions will integrate the relevant aspects of risk and compliance and put in place the means to capture and use customer data for in-life monitoring. And in doing so, they will be well positioned to reap the rewards of their forward thinking.

> **KYB is something that should be turned into a competitive advantage and we shouldn't see a difference between onboarding and in-life monitoring. It should all be just one blended experience for the customer and one blended service from the bank."**
>
> **Roger Vincent, TradeLedger**

We also asked our webinar attendees to specify the key benefits of in-life KYB. Exactly half of them said the biggest benefit was having a better understanding of customer risk. Whilst this is undoubtedly true, there are certain other benefits for both financial institutions and their customers from implementing a system of continuous client monitoring.

What are the key benefit of in-life KYB monitoring?



For regulated institutions, in-life monitoring can lead to better compliance. It can also help to mitigate the volume of alerts that KYB analysts are continually trying to manage and facilitate the better allocation of compliance resources to higher value activities and investigations. It also allows compliance teams to apply rules and triggers at a more granular level since the information they are using is consistently updated.

Over and above compliance, better in-life monitoring can be a competitive advantage too. Firms can transform what is a constraint - the need to comply with AML regulations - into an opportunity. Having accurate, recent and reliable information about your SME customers allows firms to understand, for example, when businesses are doing well and growing, or if they are having cash flow problems and need access to working capital. RMs can then offer relevant products and services in a more timely fashion, driving returns, cementing relationships and adding significant value for their clients.

Importantly, in-life monitoring can also be configured to pull updated information in an automated fashion through APIs, preventing unnecessary friction from impacting the customer's experience. In these scenarios, RMs no longer need to request updated information and documentation piecemeal from their clients. And once again, this frees them up to focus on more valuable customer interactions.

Customers benefit too from in-life monitoring, which can improve levels of service and customer satisfaction. SME owners will find that financial institutions have a better understanding of their business circumstances and financial needs, which is especially important to dynamic entrepreneurs and small business owners who are moving at speed and have retail-like expectations of access to corporate financial services.

For example, banks using in-life monitoring will have a clearer view of when SME customers need access to credit and what counts as 'normal behaviour', negating the need for unnecessary freezing or closing of bank accounts, which can seriously damage client relationships. However, experience tells us that a human touch will still be required and valued by SME customers, and leading firms will balance digital-only customer journeys with the customers' need to talk to someone about their business 1-2-1 from time-to-time.

Technology and data are the keys to success with in-life monitoring

Making a success of in-life KYB monitoring requires careful consideration of the types of technology and data that are used to support the process. However, the ability to integrate data into existing systems and processes was identified by 60% of webinar attendees as the single largest barrier to success. This should not be viewed as an insurmountable problem, however, and it is worth persevering with technology integration and digitisation efforts to deliver the benefits outlined above.

What is the biggest obstable to in-life KYB monitoring?

> **It's about leveraging technology so that people can spend more time on value added moments and interactions with SME customers rather than following antiquated, fragmented or even dysfunctional old processes"**
>
> **Denis Dorval, COO of DueDil**

As the volume, variety and velocity of new data accelerates day-by-day, it is also essential that financial institutions are crystal clear on which data will be truly useful to them in supporting their in-life monitoring journey. While a large amount of customer data is collected during the onboarding process, not all of it will be relevant to your in-life monitoring process. It is therefore essential to hone a refined view of risk to determine how best to obtain what you need in the most streamlined way. Regulated firms can think about this in two stages, separating out the data from the processes used to obtain it.

Stage 1 - look at what the existing processes are, what data they currently capture and then automate the sourcing and processing of this data in an efficient way.

Stage 2 - determine what additional information would be useful for compliance or credit decisioning, identifying relevant sources and integrating them into the new architecture.

Fortunately, data integration is much more straightforward than it used to be. Automatic Programming Interfaces (APIs) offer an easy and seamless means to connect third-party information into existing workflows. Products such as DueDil can therefore be integrated quickly - in less than a week - and rapidly begin feeding the required data into a new or existing in-life monitoring process.

For financial institutions with a vision, exploring how technology and data can support in-life monitoring can also be a catalyst to rethink and validate the whole structure of risk and compliance. And by seizing the opportunity to redesign their risk and compliance architectures, established financial institutions can set themselves up for future success.

In the race for future profitable clients, those firms that have used data to connect the dots across compliance, risk and even their sales, legal and product teams will be best placed to meet the challenges of an increasingly vibrant and competitive SME sector.

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