

KYC Guide for Fintechs

March 2023



Foreword

One of the biggest struggles and challenges of the financial industry is the combat against financial crimes. KYC efforts act as a crucial weapon in this fight as ID verification and authentication, risk assessment, constant checks and monitoring and screening are the steps of a successful customer onboarding programme that can detect, prevent or eliminate risks related to money laundering or terrorist financing crimes. FinTechs need to prioritize improvement of their KYC procedures in their investments and focus on the ways to combine digital solutions with their KYC programs to ensure the best customer experience, most effective regulatory compliance, strongest defense against the fraud and most logical operational efficiency.

With the accelerating force of digitalization, the concepts of customer onboarding, customer experience, payment systems, compliance and fight against the financial crimes require a new perspective. This whitepaper aims to discuss this new perspective in the scope of KYC. Together with the traditional definition and steps of the KYC process, newer terms and methods such as e-KYC, BNPL (Buy Now Pay Later) and AI (artificial intelligence) are explained in terms of their relation to customer verification. It is concluded that FinTechs must take a holistic approach for their customer and compliance requirements and integrate KYC and AML processes by adopting digital solutions.

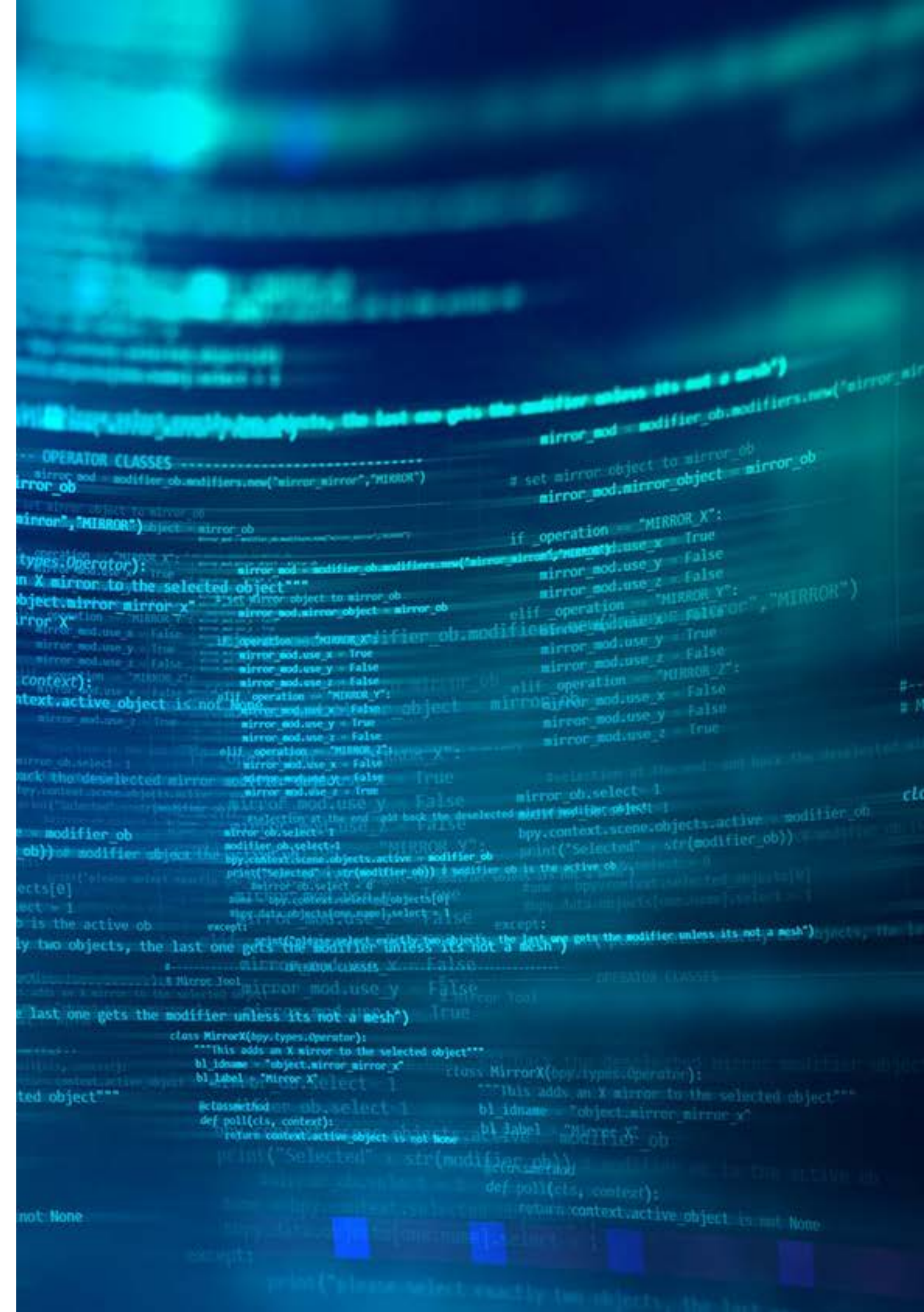
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This whitepaper elaborates on a comprehensive analysis and exploration of Know Your Customer (KYC) process with its relation and echoes on the financial ecosystem and FinTechs specifically. By taking a broader approach at the beginning, the review of the KYC concept as the first and most important step of a successful customer onboarding and the components of an effective KYC process are mentioned in the first part. The importance of KYC is analyzed within the light of a newer payment trend, BNPL (Buy Now Pay Later) in the second chapter. Finally, an integrated approach to AML and KYC is discussed to enhance the regulatory compliance, financial industry services and customer experiences.



KYC Guide for Fintechs



FinTechs need to invest in digital solutions to fight against financial crime, while also providing a smooth and secure digital onboarding process for customers.

Technology and digitalization are the fastest-evolving fields of our era and together with the push of the catalysts such as COVID-19 pandemic, the acceleration of evolution has gained extra momentum. The effects of this focus on the digitalization and its acceleration reflected themselves in the finance industry in a reciprocal image. On the one hand, the digitalization of the customer onboarding and authentication processes enhanced the financial service industry in terms of pace, customer experience, security and sustainability. On the other hand, with the evolving technology, financial criminals manage to find newer ways to exploit the systems and apply fraudulent schemes.

In order to fight against the financial crime industry, the FinTechs need to make sure that they invest enough in digital solutions and improve their KYC (Know Your Customer) knowledge and efforts. Digitalization of the customer identification processes is also in line with the better customer experience as the customers are becoming more digitally savvy and expecting to receive their financial services in a smoother digital environment. While ensuring a frictionless digital onboarding process for the customers, the financial institutions need to ensure that they provide security by collecting, validating and monitoring customer data.

In this whitepaper, the basics of the KYC (Know Your Customer) processes, the definition of the main concepts in relation to customer onboarding and how they help the FinTechs improve their financial services and customer experiences will be explained and analyzed in detail. In the second part, a recent payment trend of Buy Now Pay Later (BNPL) and its relation to KYC (Know Your Customer) will be the main focus. In the final section, the integration of KYC (Know Your Customer) and AML (Anti-Money Laundering) processes for FinTechs will be discussed in the light of digitalization.



**Basis of Customer Onboarding
and Customer Experience**

1. Basis of Customer Onboarding and Customer Experience

1.1 Know Your Customer (KYC)



KYC process is critical for financial institutions to verify the identity, relevance, and potential risks of customers.

The financial institutions are responsible for the verification of their customers' identities and their genuinity. Know Your Customer (KYC) processes refer to a set of guidelines that the FIs (Financial Institutions) are entitled to follow and apply in order to verify the identity, pertinence and potential risks of a current or potential customer.

Therefore, operating an effective and a successful Know Your Customer (KYC) process has a critical importance in the financial world because it serves as one of the most crucial tools in the battle against the financial crimes, especially money laundering as it can detect a suspicious customer behavior and the FIs can act upon it prior to its materialization into a financial crime. The financial institutions apply KYC checks on new account openings and on a regular basis for the ID verification of a customer. In the event of a failure in meeting the KYC requirements, the FIs can terminate the business relationship and refuse to open an account for that specific customer.

There are several important components of a properly functioning KYC system including but not limited to Customer Identification Program (CIP), Customer Due Diligence (CDD) and Enhanced Due Diligence (EDD).



Customer Identification Program (CIP)



Customer Due Diligence (CDD)



Enhanced Due Diligence (EDD)



e-KYC

1. Basis of Customer Onboarding and Customer Experience

Customer Identification Program (CIP)



The most basic data that the FIs need to collect from their customers in order to identify their genuinity are the name, date of birth, address and ID number. In addition to these, it is the firm's own initiative to benefit from additional sources for the screening purposes such as sanction lists, PEP (Politically Exposed Person) lists or other black lists. The role of the CIP is an advisory one as it is in the institution's judgment to decide what is the level of the risk and which policy to apply for that specific level.

Customer Due Diligence (CDD)



Customer Due Diligence (CDD) is an important step of Know Your Customer (KYC) processes and requirements as it is the set of processes used for the classification and analysis of the data collected via Customer Identification Program (CIP). By evaluating the collected information, CDD aims to verify the potential or existing customer's identity and detect any suspicious activity or potential risks that threaten the financial institution's way of doing business. Performing Customer Due Diligence (CDD) processes on a regular basis is essential because financial crimes tend to be committed very quickly. The FIs need to apply ongoing monitoring for detecting unusual activities and making sure to involve any changes in the sanction lists. Although most customers carry only a little or no risks, there are specific cases where Enhanced Due Diligence (EDD) needs to be applied.

Enhanced Due Diligence (EDD)



Enhanced Due Diligence (EDD) is a risk-sensitive, enhanced form of Customer Due Diligence (CDD) which is put into action when a customer exhibits suspicious financial behavior and poses potential risks so that the FI can understand what is actually behind those unusual activities. In most cases, the high-risk persons are politically exposed people or those who are in close relation with them. Precautions and extra steps taken within the framework of Enhanced Due Diligence (EDD) procedure include background information, source of funds, source and structure of wealth and adverse media screening.

e-KYC



e-KYC (Electronic Know Your Customer) refers to the digitalization of the KYC (Know Your Customer) processes and it means Electronic Know Your Customer. It aims to increase efficiency, speed and accuracy in risk detection and KYC processes via remote, paperless and automated processes and to minimize the costs and traditional bureaucracy necessary in KYC processes. e-KYC and machine learning are becoming more and more preferable and advantageous in the financial ecosystem because they offer the most effective digital solutions for the CDD processes and therefore AML and CFT frameworks as well. For the purpose of increasing efficiency, speed and accuracy in risk detection and management against the financial crimes of money laundering and terrorist financing, financial institutions are looking for new ways to implement AI (artificial intelligence) and ML (machine learning) based monitoring systems into their already existing customer onboarding processes or adopt and settle a totally new system from scratch.

1. Basis of Customer Onboarding and Customer Experience

1.2 Better Customer Onboarding, Better Customer Experience



The digitization of financial services has resulted with higher customer satisfaction, which benefits for both customers and financial institutions.

Customers of the digitized financial ecosystem have a high expectation to access and benefit from faster and easier use of online services. This also covers customer onboarding processes of the financial institutions when a customer wants to open a new account or for the regular verification checks. Digital customer onboarding incorporates various needs and expectations of digitally-savvy customers by increasing the levels of flexibility and user-friendliness of the financial services via online tools. Additionally, customers can make use of mobile technologies such as e-signature and real-time banking facilities in a secured online environment, overcoming physical barriers.

As a result of the enhancements in the digital ID verification processes, the risks associated with the fraudulent activities and money laundering have been minimized. Enhancements in the customer onboarding processes with increased flexibility, accessibility and security helped boost the overall efficiency of the FIs as it directly affected the levels of customer satisfaction and loyalty in a positive manner. Automated systems installed for digital onboarding purposes operate end-to-end and minimize the need for manual intervention which results in tremendous amounts of time-savings and a higher number of transactions on the customer side. Digital customer onboarding eventually turns out to be beneficial to both the customers and FIs as the customers enjoy seamless, faster and more flexible online financial services, the FIs ensure that they remain compliant with the advancements in the regulatory landscape, as well as they can take advantage of cost- and time- effectiveness.



**Know Your Customer (KYC)
for Buy Now Pay Later (BNPL)**

2. Know Your Customer (KYC) for Buy Now Pay Later (BNPL)

2.1 What is the “Buy Now Pay Later” (BNPL) Trend?

Buy Now Pay Later (BNPL), also referred to as the point-of-sale installment loan, is a Fintech solution which offers an installment loan without any interest. Consumers can use the BNPL option in their purchases to receive the item they buy immediately but pay it over a series of equal installments. Even though the BNPL option has been available in the market for several years now, it has started to become popular with the outbreak of the COVID-19 pandemic when the tendency of the consumer spendings turned towards online shopping.

In most cases, the BNPL option can be chosen on the checkout screen where the customer is typically asked to provide specific information such as name, email address, date of birth, phone number, social security number and the payment method.

2.2 Why is It Important for FinTechs?

BNPL arrangements gained a fast-moving momentum in the FinTech industry with their innovative and disruptive nature of offering a short-term debt option. This abrupt surge occasionally raised questions regarding regulations. In terms of legislative obligations, BNPL arrangements mainly rely on “responsible spending” from the perspective of the customers as BNPL provides a cheaper option for loaning in comparison to its alternatives which are credit cards. Therefore, BNPL eludes from “responsible lending” legislation which is normally applied to short-term credit products alike.

As the popularity of the BNPL is rising among consumers, the regulatory framework for the BNPL arrangements requires more attention. In order to be able to prevent fraudulent activities conducted via BNPL such as money laundering and terrorist funding, the necessity for the solutions focusing on KYC and AML are acknowledged by the regulatory authorities globally. The Consumer Financial Protection Bureau (CFBP) of the U.S published a report in September 2022 listing the risks associated with BNPL which include weak security and consumer protection, debt accumulation possibility and data harvesting. Compliance officers and leaders agree that BNPL companies should legally comply with KYC and AML regulations to ensure that they conduct effective onboarding processes for their customers.



The BNPL option has gained popularity and allows consumers to receive their purchased item immediately but pay over a series of equal installments.

2. Know Your Customer (KYC) for Buy Now Pay Later (BNPL)



Digital ID verification solutions can help BNPL companies to verify the authenticity of their customers and prevent financial crimes, while strengthening their KYC program through customer risk scoring & assessment, and ongoing monitoring.

2.3 What is the Relationship Between KYC and BNPL for FinTechs?

As with the other digital payment platforms, BNPL is also a target of cybercriminals and fraudsters because the security and regulatory enforcements remain weaker. The threats and risks facing the BNPL users are mainly related to data breaches and identity/account theft. Therefore, identity verification and other processes supporting this are highly crucial for BNPLs as well as any other digital financial services for preventing digital financial crimes. FinTechs providing or supporting BNPL services need to realize the importance of KYC procedures and to review their operation systems accordingly. According to the UK's National Fraud Database, among all the fraud cases, the identity fraud has a 61% share and it is also stated that in the last 5 years, the number of ID fraud incidents have risen by 32% as the use of online services are increasing among consumers.

BNPL firms being more vulnerable to the cyber attacks as they are mildly regulated can prevent the identity fraud and other related crimes by applying effective KYC & AML solutions to identify, authenticate and verify their existing and new customers during onboarding.

2.4 How Can an Effective KYC Program Leverage a Successful BNPL Process?

By verifying the authenticity of their customers, BNPL companies can take the biggest step in fighting the misuse of their platforms for the purposes of financial crimes. To that end, they need to ensure that each collected data about their customers is accurate. With the help of digital ID verification solutions, BNPL providers can run an effective KYC program which will help block fraudsters and provide a smoother customer experience.

There are several ways to strengthen the KYC program that will leverage the success of the BNPL service overall. Implementing or improving the customer risk scoring and assessment system, ongoing and real-time monitoring of the customer transactions and activities, deploying or enhancing a strong and secure ID verification system are among the most effective methods that a BNPL firm can apply to set up an effective KYC process.



**Integrated KYC and
AML Processes for FinTechs**

3. Integrated KYC and AML Processes for FinTechs

AML (Anti-Money Laundering) refers to the whole set of processes applied for checking different data sources to detect and prevent money laundering activities. The financial institutions and FinTechs are entitled to operate effective and comprehensive AML procedures that include all the steps from customer ID authentication to monitoring and record-keeping in order to prevent any possibility of financial crime. FIs that fail to comply with the AML requirements, with or without intention, are faced with severe fines.

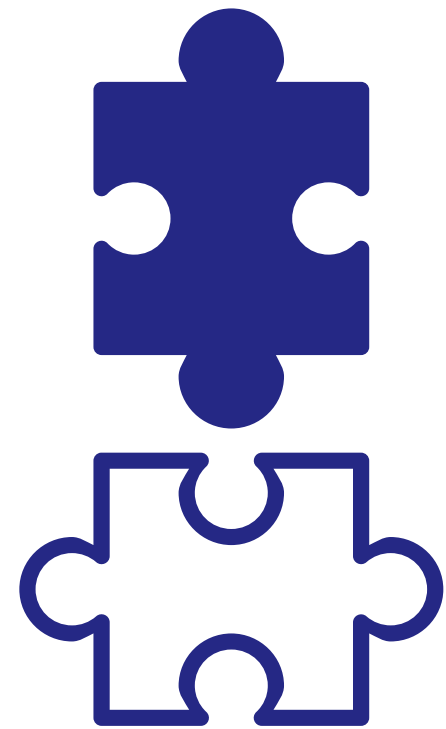
FinTech companies, as all the financial institutions do, have to follow the AML directives and requirements, therefore need to integrate effective KYC and CDD procedures into their customer onboarding processes. A successfully operated KYC process directly affects the overall performance of the AML program within an institution because AML encapsulates all the processes including KYC, CDD, EDD and others related to customer verification for risk management and prevention of the financial crimes.

3.1 Benefits of a Holistic Approach

A thorough process of customer onboarding including effective KYC, due diligence and monitoring steps feeds both the success of the AML compliance and customer satisfaction. FinTechs that acknowledge the importance of building an integrated KYC and AML system supporting each other are highly likely to enjoy the benefits of remaining compliant with the ever-changing and demanding regulatory requirements, satisfying the needs of the tech-savvy customers, increasing the trustworthiness of their business and enhancing the operational efficiency.

3.1.1 AML Compliance through KYC Procedures

Applying the KYC components of CIP, CDD, EDD and making sure to re-apply them regularly by monitoring the customers, the FIs can prevent financial crimes of money laundering and fraud up to a great extent. The regulatory requirements are getting more demanding and challenging in the digitalized financial industry to make sure that the financial institutions are taking the necessary precautions and actions against the financial crimes. In this environment, the responsibility of the FIs is to detect, prevent or eliminate potential risk while at the same time remain compliant with the AML regulations. That is why it is dramatically crucial for the financial institutions to employ a successfully working KYC strategy.



Incorporating an effective KYC, due diligence, and monitoring process during customer onboarding can lead to successful AML compliance.

3. Integrated KYC and AML Processes for FinTechs

3.1.2 Effective KYC Procedure Evolves Customer Experience

Together with the help of the digital solutions that speed up the processes of customer onboarding substantially, the KYC processes have become a lot simpler, faster and user friendly. AI-powered KYC softwares enables potential customers to complete their onboarding processes online without a need to visit a branch physically or spending hours to complete the ID verification steps. Better customer experience automatically turns into better conversions and higher loyalty.



The operational efficiency within the financial institution can be increased with the help of an automated KYC system.

3.1.3 KYC Increasing Stability

By completing the AML compliance requirements and obeying the laws, the FinTechs also build stability and trust for their businesses. Trustworthiness is essential for a business to attract more customers, receive additional investments and eventually add up to the profit.

3.1.4 Operational Efficiency Maximized with Digital KYC Solutions

The operational efficiency within the financial institution can be increased with the help of an automated KYC system because it can analyze and process big volumes of data in less time with higher accuracy. Therefore, a computer-based KYC system is capable of eliminating risks related to human error. Adoption of a digital KYC solution for a more effective onboarding process and better compliance reduces the workload and costs of an institution to a great extent.

Conclusion: KYC at the Core of Fight Against Financial Crimes



4. Conclusion: KYC at the Core of Fight Against Financial Crimes



Following topics discussed and explained in this whitepaper, it is possible to acknowledge that Know-Your-Customer forms the basis of the most important procedures required to fight financial crimes effectively.

FinTechs and other financial institutions need to be aware of the dynamics of the digital financial industry, strive for minimizing the complexity and remaining compliant with the regulations at the same time in order to build an efficient KYC strategy.

Achieving a successfully working KYC system ensures better customer onboarding and better customer experience as well as preventing fraud and money laundering crimes. As new trends in the payments industry continue to emerge in line with the developments in the digital world, a solid and functioning KYC system will remain crucial for the financial institutions in verifying the identity of their customers and protecting their businesses against the risks and threats.

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About Us

Milestones

Fineksus was founded in Istanbul, Turkey in 2002 as a software and professional service provider to deliver technical consultancy, outsourcing services, standalone / SaaS AML and payment software solutions for banks, brokers and corporations. In the beginning of 2013, Fineksus started managing its ongoing GCC Region operations at its new office in Dubai, UAE.

Fineksus is the market leader of compliance and financial messaging solutions in Turkey by providing its products and services for more than 95% of the banking industry, and aims to expand its offerings global wide which makes the company at the forefront for providing AML solutions and financial messaging tools.

PayGate™ Suite as AML trademark

Fineksus provides products and services across 32 countries from Hong Kong to the UK with offices in Istanbul, Dubai and Baku. By meeting the ever-changing demands of RegTech industry with 20 years of know-how, Fineksus develops cutting-edge tools to bring value for more efficient and effective AML compliance and financial messaging technologies. PayGate™ Compliance package covers all the fundamental operations based on AI and machine learning to maintain surveillance of financial systems.



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Know your customer.
Know your risk.



PayGate™ Analyzer
Next generation
transaction monitoring.



PayGate™ Inspector
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