Taking a risk-based approach to client onboarding

A case study with Pinsent Masons

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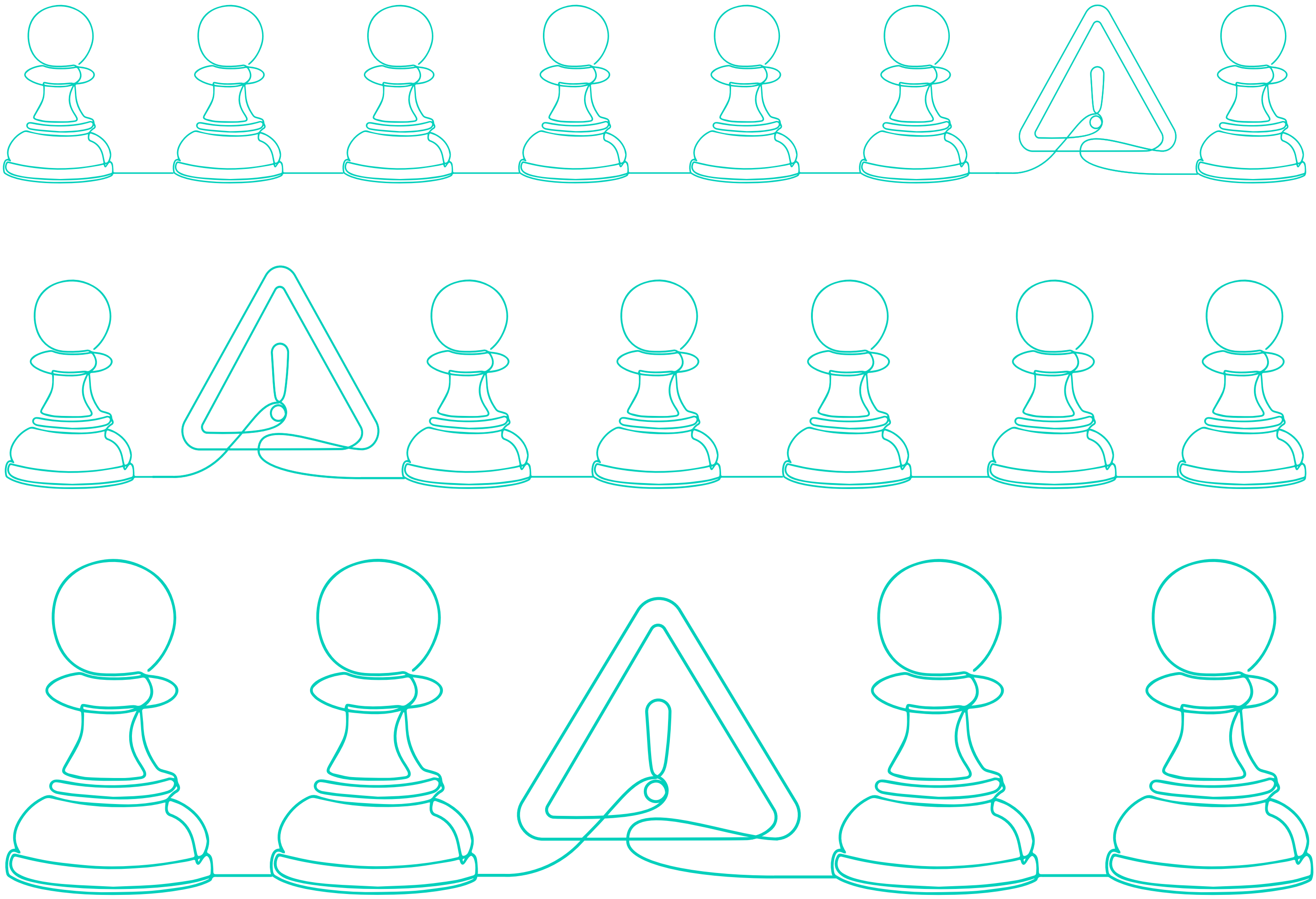

Introduction: finding balance

Pinsent Masons recognised a major challenge affecting all AML-regulated businesses globally: taking a truly risk-based approach to AML compliance using traditional tools and methodologies is slow and painstaking work. This forces businesses to adopt an unbalanced approach to AML risk management. AML systems and controls by necessity have to focus on the onboarding of clients rather than balancing their risk management efforts across the whole of a client relationship and their matters.

Conducting full due diligence on each client and their matters is time-intensive–a frustration for both firms and clients. Disproportionate amounts of time are spent on processing low and medium risk clients, which diverts attention and resources from higher risk clients and matters.

Pinsent Masons concluded that radical technological solutions were needed to streamline the onboarding process to create a better-balanced AML compliance system that meets the needs of clients and business as well as the growing complexity of international regulatory requirements.

This e-book explores how Pinsent Masons are collaborating with Xapien to design, test, and co-develop a fully automated AML due diligence and risk assessment tool.

The AML challenge impacting bottom-lines

Many firms have centralised client onboarding processes supported by standardised AML policies. In these systems, client-facing staff or partners gather necessary client information, which compliance teams then review in line with the firm's AML risk appetite and policy and applicable AML laws and regulations. Compliance teams tend to be made up of junior analysts supervised by a small number of specialised lawyers and compliance professionals. These are expensive and increasingly in-demand resources.

This approach, while orthodox, is far from perfect. It means that firms often have to adopt higher standards of due diligence collection and assessment than might strictly be necessary: the global gold standard approach.

Firms need to make pragmatic trade-offs between cost, complexity and speed of processing for the compliance team. A nuanced system that takes into account different levels of risk posed by clients, considers whether work is regulated or not regulated and applies only the applicable AML local rules and guidance requires a large number of more highly specialised and experienced compliance personnel to administer. Without enhanced ongoing auditing and monitoring, the risks of that system resulting in a regulatory breach are higher. On the other hand, a less nuanced global gold standard approach can be administered more cheaply and safely by the centralised compliance team but pushes more work onto the partner and fee earner teams who need to collect due diligence and introduces material levels of delay within the system. The average time it takes to onboard clients using this model for larger firms can easily run into the millions of hours per year but that business impact is seldom quantified because it is a 'soft cost' (though often complained about).

Without a triage system to differentiate clients by risk level, compliance teams can and do misplace focus and spend a disproportionate amount of time and effort on low-risk clients and matters. This lack of differentiation generates more work for in-house compliance teams and client-facing teams. It also impacts client relationships and impacts the firm's bottom line when billable work is delayed and fee-earning time is being taken up dealing with AML queries that do not reduce the risk posed by the client.

It is an uncomfortable truth that the gold standard approach is only sustainable because everyone is doing it.

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The impact on risk culture

AML is a process. When that process is done thousands of times per year and is by design onerous because it applies higher standards than are legally applicable, people switch off. It's regrettable, but it is human nature. This is further exacerbated by the orthodox approach firms take to AML compliance: centralised compliance teams applying the gold standard. It is too easy for fee-earning teams to disengage, to forget the importance of AML checks and why they need to do them, and to see this as the responsibility of the centralised AML team, rather than their own. In the SRA's prosecution of Clyde and Co for AML systems failures, it is telling that the partner involved admitted to the Solicitors Disciplinary Tribunal that he had probably become "too detached" from the due diligence process. That detachment cost him personally and the firm £500,000.

When due diligence becomes onerous and exceeds internationally applicable local requirements and markets, fee earners disengage from client risk assessments, seeing it as a task to offload to compliance without meaningful involvement. This disengagement limits their opportunity to provide valuable insights on client risk and reduces their understanding of the risks associated with the clients they bring in.

By undermining the effectiveness of ongoing monitoring, firms are exposed to much higher levels of direct money laundering risk: namely, the risk that in the course of a matter a client engages in, and so causes the firm to engage in, a primary money laundering offence.

A strong risk culture requires everyone to share an understanding of the importance of risk management, focusing on its protective value rather than just the costs of compliance and checklists. Streamlining the onboarding process for clients by tailoring due diligence to their actual risk profiles reduces delays whilst still meeting the regulatory standards that apply. When fee earners see compliance steps adjusted based on risk and when their involvement is focused on meaningful AML and reputational risks, they're more likely to view the process as both reasonable and valuable.

What is a risk-based approach?

A risk-based approach is the foundation of all AML compliance. It requires firms to identify, assess, and thoroughly understand the specific money laundering, terrorist financing and proliferation financing risks they face. This starts with conducting a detailed risk assessment, looking at geographic, client, matter, and delivery channel risks.

If risks are identified, firms must implement appropriate measures tailored to the level of risk. For instance, Enhanced Due Diligence (EDD) on high-risk clients and simplified checks for low-risk clients. Taking this approach allows firms to allocate their AML analyst resource strategically. When applied effectively, human analyst time is focused on the subset of higher-risk clients where human judgement and expertise are paramount.

'When that process is done thousands of times per year... people switch off.'

The barriers to an effective risk-based approach

The Financial Action Task Force (FATF) guidance is clear that due diligence should be tailored to a client's risk profile. However, most compliance teams rely on initial AML screening to construct a client's risk profile.

While screening is an important first step, it provides only a partial view of a client's risk level (i.e. whether they are sanctioned, a Politically Exposed Person, or on a watchlist). It provides no wider insight about the client other than whether they appear on these constrained datasets.

Consequently, due diligence isn't really performed in proportion to risk. With only a few million entries on those lists and billions of individuals in the world, just because a client isn't in an AML compliance database doesn't mean they aren't risky. To strengthen risk assessments, compliance teams must move beyond surface-level checks.

The Thomson Reuters 2023 Risk and Compliance Report found that 70% of risk and compliance professionals say their firms are transitioning from tick-box compliance to a more strategic approach.

The problem is that most firms lack a process that supports a truly risk-based approach. Indeed, it could be said that the orthodox approach firms take to centralised AML compliance make it impossible to do so. With an overly rigid client onboarding process designed to ensure global AML compliance–and a continuous flow of new clients to onboard–immense pressure is placed on compliance teams. This makes it difficult to assess each client's risk profile thoroughly before determining the appropriate level of due diligence.

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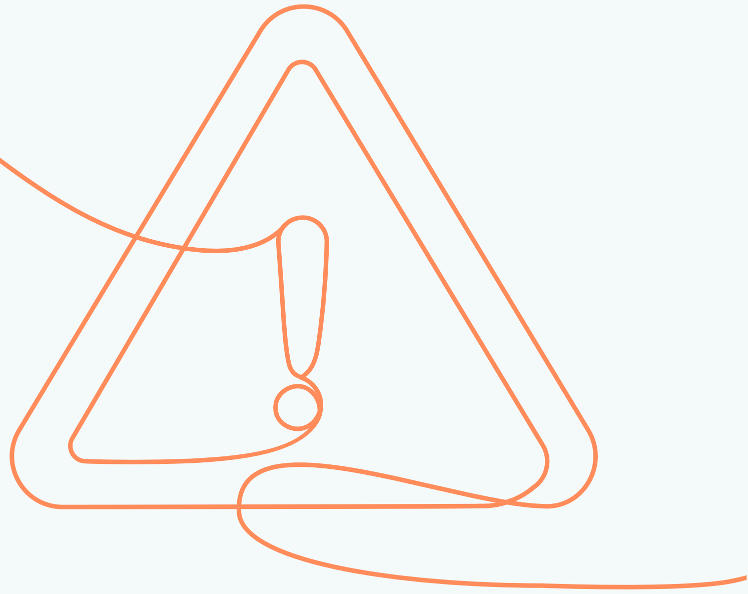
Building a risk profile using qualitative insights



The information that compliance teams need to take a risk-based approach goes beyond structured databases to publicly available information. Open-source information, such as news reports and high-profile documents like the Panama Papers, can provide critical insights into a client's reputation, behaviour, and associations.

By adopting this multifaceted approach, compliance teams are better equipped to identify potential red flags, assess the full scope of a client's risk profile early on, and make decisions that align with the risk-based approach. Here's what a comprehensive and qualitative due diligence report using open-source research should contain.

Biography

The client's full name, any aliases, and 'also known as' (AKA) names. It can be difficult to identify every name linked to an individual, so it's important to carefully cross-reference dates of birth and other identifiers to confirm it's the right person.

Residence and geopolitical links

The client's current residence and connections to countries that are high-risk or have geopolitical tensions. Having these links to certain individuals can indicate a higher likelihood of corruption, money laundering, or other illicit activities.

Relationships and associations

The client's wider network and relationships is a key part of their risk assessment. Identifying influential friends and associates can reveal potential avenues for corruption or unethical behaviour.

Crime and controversy

The client's history of any past crimes and controversies, detailing any financial or non-financial offences, convictions, and allegations. Context is important here since it helps fee-earners recognise future behaviour patterns that are unusual.

Wealth

The client's net worth and source of wealth can help identify any red flags related to financial crime. Investigating the origins of their wealth is essential to provide assurance that it was obtained through legal means and that the transaction makes sense based on the client profile.

Assets

The client's assets must be assessed to verify the legitimacy and their sources, as well as check whether assets are hidden or involved in sanctioned activities.

Why open source research is hard

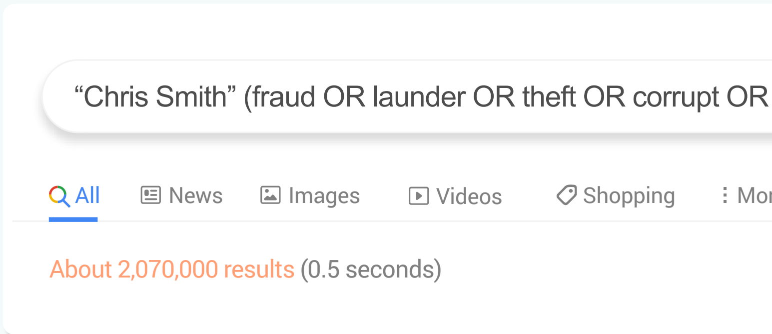
While these contextual insights are crucial to building an accurate risk profile, the manual methods analysts often use to find them are highly inefficient and prone to error.

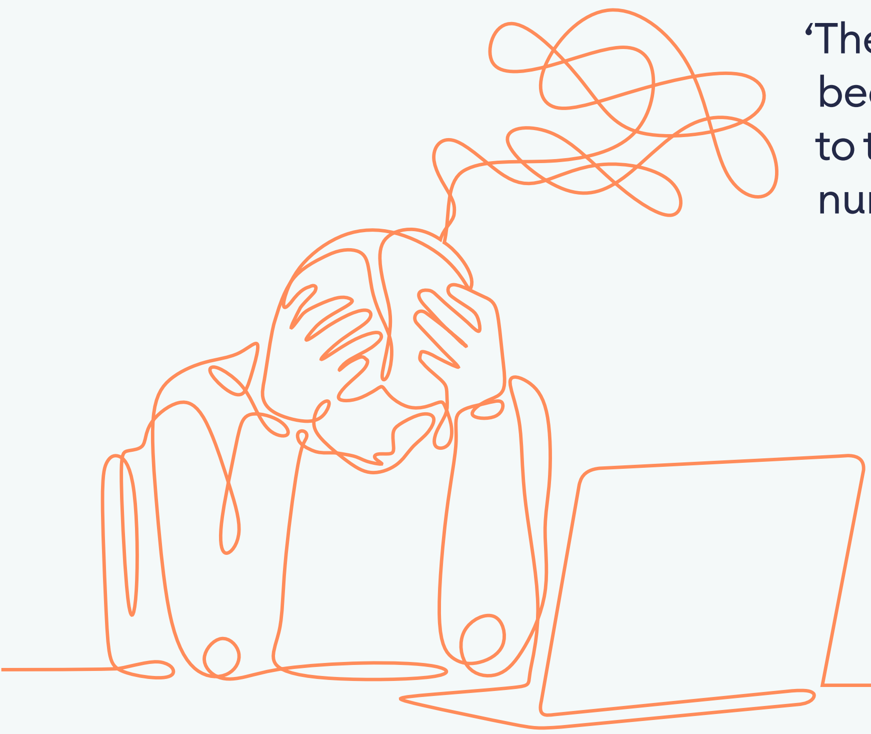
The process usually starts with screening clients against structured databases, which helps identify immediate risks, such as political exposure or sanctions, where they exist. Of course, most individuals and entities aren't on these lists. Once that step is complete, an analyst would then turn to a Google search, or a search on another search engine. While this may seem straightforward, the process quickly becomes complex due to the overwhelming number of search results, many of which may be irrelevant or outdated or are in languages in which the analyst is not fluent.

To get meaningful results, analysts use specific search strings, combining the subject's name with keywords like 'fraud,' 'money laundering,' or 'embezzlement.' This helps surface relevant information, but it requires precision in both phrasing and filtering. This too is an inherently limited process. What about all the risks that you didn't search for or know to search for?

To make the process manageable and scalable in an organisation, analysts are often instructed to limit their searching, typically restricted to the first 10 or 15 pages of results from a search engine. As a result, significant risk indicators–such as links to fraudulent activities, negative media coverage, or involvement in legal disputes–could easily be missed, leaving compliance teams with incomplete risk profiles.

Even within these limits, this manual methodology doesn't scale effectively. Analysts spend large amounts of time cross-checking database results with online information, summarising their findings, and producing the final reports to clear the onboarding queue. But in doing so, they sacrifice the time and depth needed to properly assess and prioritise higher-risk clients. With all clients receiving the same level of scrutiny, the risk-based approach falls short and the balance required for an effective and holistic AML system suffers.





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How can law firms take a risk-based approach?

Compliance teams can only apply accurate risk-based measures when they have a comprehensive understanding of a client from the start and this needs to be done quickly and automatically. This broader view ensures that potential risks are identified early, allowing for appropriate actions such as monitoring, reporting, or escalating issues for further investigation.

This has created the need for an Initial Due Diligence (IDD) process, which serves as an intermediary step between initial screening and more in-depth Customer Due Diligence (CDD). It provides an extra layer of scrutiny to better assess risk before committing to more resource-intensive investigations, such as Enhanced Due Diligence (EDD).

Historically, Initial Due Diligence has relied heavily on ID verification (IDV) and anti-money laundering (AML) checks. While effective for basic clearance, these methods only provide binary yes or no answers, failing to offer meaningful insights into a client's risk profile.

Advances in AI technology, such as Machine Learning (ML) and Natural Language Processing (NLP), now empower compliance teams to conduct deeper due diligence further upstream. That's why compliance leaders are investing heavily in technology to automate practices and procedures (24%), streamline workflows (22%), reduce costs (21%), and cut time spent managing risk and compliance tasks (20%).

AI technology not only improves the accuracy of risk assessments but also reduces the cost and time. With manual processes minimised, compliance teams can scale onboarding operations and consistently apply a risk-based approach to clients. Most importantly, they can divert limited time and resources away from lower risk clients and matters to higher risk clients and matters and ongoing monitoring efforts.

Implementing an Initial Due Diligence process

Like Customer Due Diligence, the Initial Due Diligence process begins by screening clients against AML databases to ensure they aren't politically exposed, sanctioned, or on a watchlist.

This preliminary check is the foundation of a client's risk assessment. But then compliance teams must interpret that data within a broader context, using information from the entire indexed internet to apply a genuinely risk-based approach.

They need to catch potential risks not just from databases, but also from information about clients in the public domain. This takes Initial Due Diligence from a basic AML check to a comprehensive risk assessment.

There are limitations to conducting this process manually. To establish a sustainable Initial Due Diligence process, compliance teams need a sophisticated technology tool that automates the time-consuming tasks of research, analysis, and reporting. Most importantly, it should combine AML screening with reliable open-source research capabilities.

How Pinsent Masons take a risk-based approach

Pinsent Masons' General Counsel recognised that digitisation was essential for the compliance team to conduct due diligence earlier in the onboarding phase in a way that better balances resources. However, the firm faced challenges in finding a tool that was both reliable and trustworthy. This led them to partnering with Xapien to co-develop the legal market's first AML due diligence tool powered by a Large Language Model (LLM).

Once the tool is integrated into the process, the firm expects low-risk clients to be cleared in hours as opposed to days. Rather than spreading their focus equally across all clients, Xapien will enable its analysts to allocate resources more effectively to higher-risk cases, applying the appropriate level of AML controls to each client and completed focused ongoing monitoring checks.

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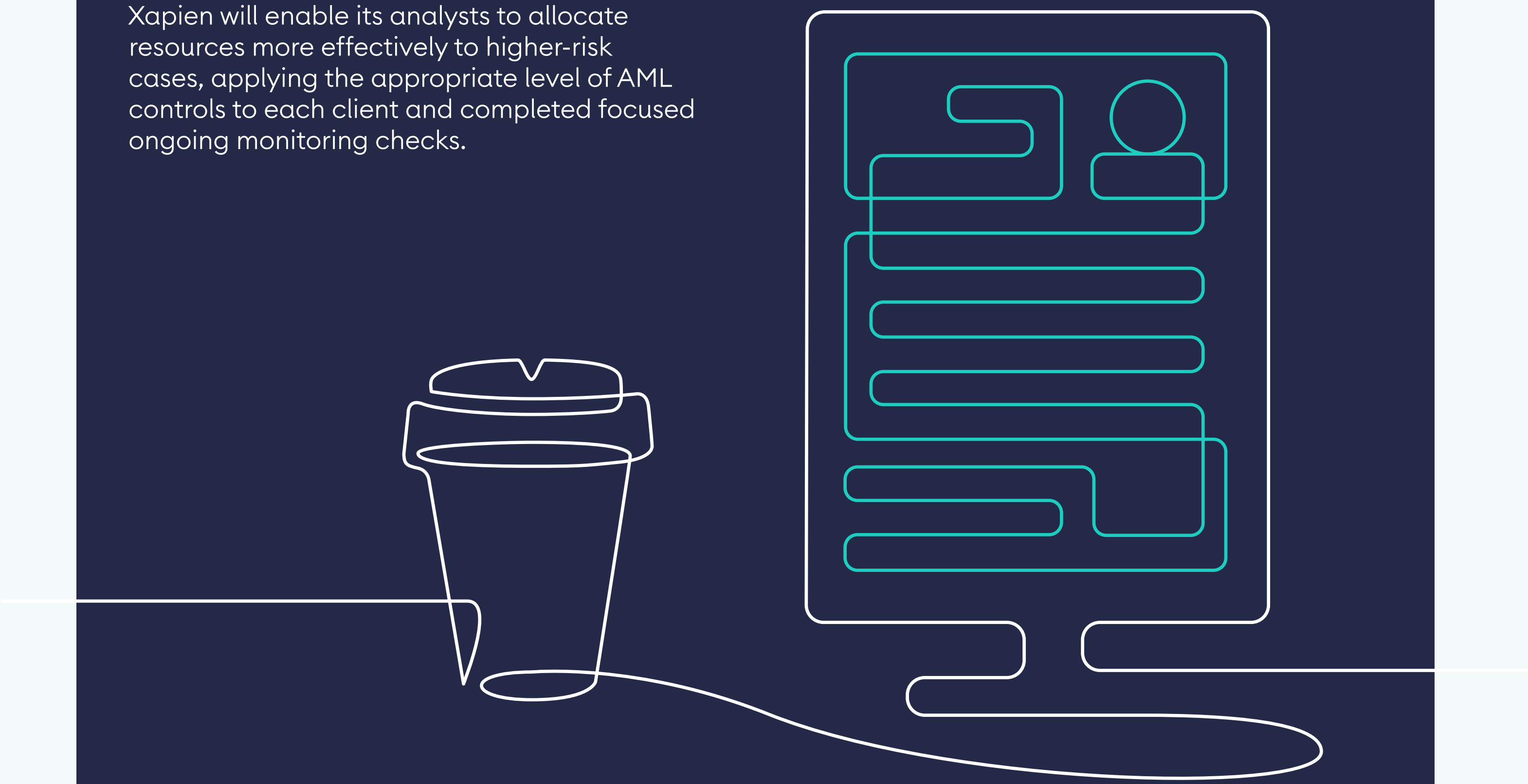


Pinsent Masons

Initial Due Diligence enabled by Xapien

Xapien is an AI-powered research tool that provides enriched information on any subject, so law firms can adopt a wide-angle lens for client risk assessments. Guided by the General Counsel and a dedicated team of risk and compliance professionals, the tool is being developed to gather data from various corporate information and AML databases. This will enhance the efficiency of Pinsent Masons' current AML compliance process through automation and high-quality data integration.

While beneficial for various aspects of legal practice and operations, this tool is mainly designed to help law firms with client onboarding for AML checks before clearing clients. By automating these checks and providing deeper insights from open sources, it can significantly speed up client onboarding times. This is crucial for firms like Pinsent Masons since many clients go through the process at once.

The tool will perform both primary and secondary data collection. It first gathers essential Know Your Customer (KYC) and AML information, such as registered office addresses, shareholders, directors, and ultimate beneficial owners. It then performs a secondary search across the indexed internet to gather supplemental open-source information.

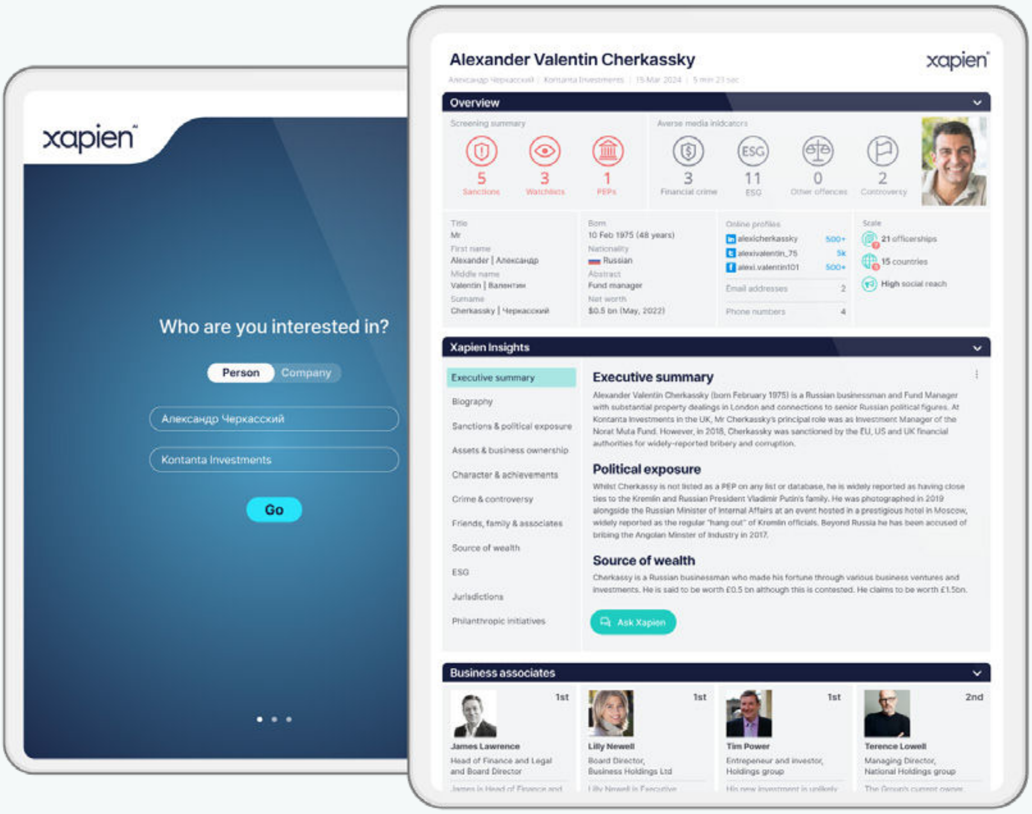
In around **15 minutes**, Xapien will generate a detailed report that identifies potential AML risks, anti-bribery and corruption (ABC) risks, and environmental, social, and governance (ESG) risks. It will also flag risky connections and associations that manual checks might miss.

Utilising risk assessment methodologies, the report will assign a risk rating to the client based on the data collection completed. If the report indicates a low risk, it will be passed through the system with minimal oversight. For medium-risk cases, the report will be sent to the AML team for further evaluation. If the analyst determines that a case is high risk after their review, additional verification will be required based on the specific risks identified for the client. This might involve scrutinising the Xapien report in greater detail, consulting with the partners, or requesting further information from the client.

The end goal is for the platform to provide a comprehensive due diligence report that outlines the collected data, the risk assessment results, any missing information, and a complete picture of the client's risk profile. Enabling the compliance team to make informed decisions about the next steps based on a risk-based approach.

"Xapien does what would take me hours or days in a few minutes."

Senior Analyst, Risk Consultancy



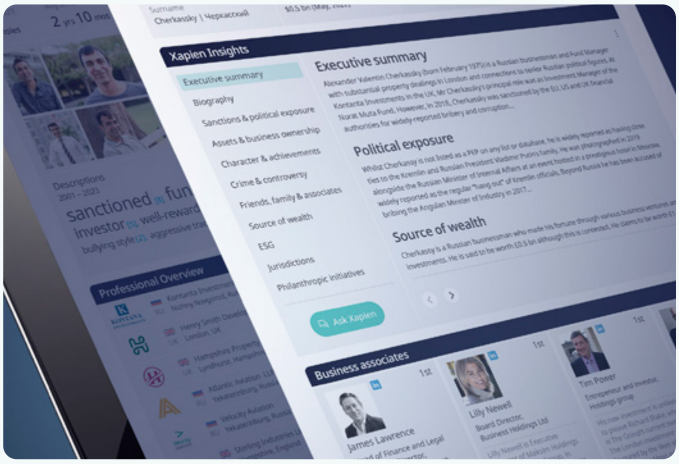
Xapien can help your firm realise a truly risk-based approach

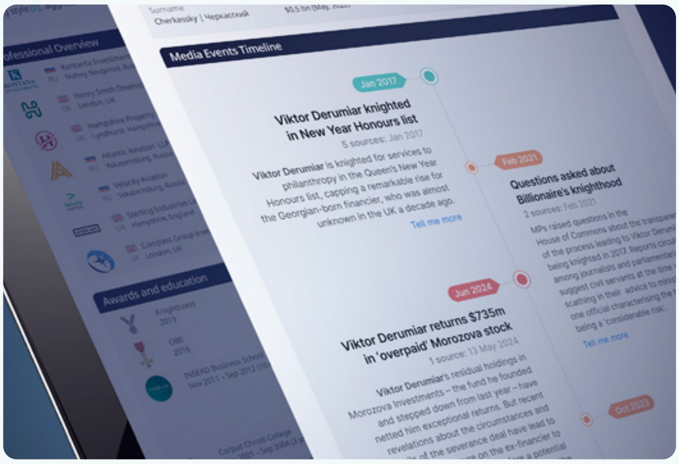
For firms that rely on traditional screening and manual research, Xapien facilitates a far more effective use of critical human resources, with rapid insights on all clients from the moment they begin the onboarding process. It provides a comprehensive view of risks, enabling your compliance team to genuinely tailor the next steps, whether that involves further investigations or clearing clients in minutes.

Moreover, it doesn't require you to overhaul your existing technology stack or add another tool to an already overflowing suite of products. Xapien serves as a single source of truth for the most accurate and reliable upfront view of a client, preventing your compliance team from having to navigate fragmented solutions.

This has transformative consequences for law firms. The reductions in partner time invested in collecting client data for onboarding, and analyst time in reviewing and cross-referencing data results in millions of pounds worth of savings. Moreover, partners can start billing clients and serving them faster. This provides firms with a competitive edge when clients may be scoping other firms. Finally, the firm is better protected with a comprehensive AML process that remains in line with the risk-based approach.

5 Sanctions | 3 Watchlists | 1 PEPs





> "Seeing the product was a Eureka moment."

Head of Claims Fraud, Zurich Insurance

Book a demo

See for yourself how Xapien's AI-powered research and due diligence tool goes faster than manual research.

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