As the financial industry wages its enduring struggle to combat money laundering, behavioral science experts argue that a major weakness in many bank know-your-customer (KYC) programs is the lack of understanding of how employee judgment, biases, and organizational structure can play an influential role in the effectiveness of the process.

"I think the biggest mistake is that (financial firms) assume when you design what seems to be a clear-cut process, that people do the right thing within the process," says Femke de Vries, managing partner at **&samhoud**, a Dutch management consultancy that applies behavioral science techniques.

"But there are a lot of moments in the KYC process that require a judgment call and that's what is not taken into account," de Vries says. "(Banks) assume that as long as we provide people with the right information, they will make the right judgment. But that's not necessarily how judgment works."

Banks may have multi-million dollar anti-financial crime budgets, and anti-money laundering (AML) and KYC staff that reach into the thousands of employees, but tackling financial crime remains a serious problem. Part of the issue is that it's difficult to train so many people to be effective, and thus, many AML/KYC risk management frameworks are inadequate.

In 2019, some of the industry's largest institutions unveiled plans to increase their KYC budgets and headcount. ING, the largest Dutch lender, announced it was spending 200 million euros to enhance its KYC and AML efforts. Deutsche Bank, meanwhile, invested 700 million euros in upgrading anti-financial crime, compliance, and cybersecurity technology over the last three years.

Using a behavioral lens to understand KYC processes

In a recent interview with Thomson Reuters Regulatory Intelligence, de Vries, and her colleague, Wieke Scholten, described how they have been working with banks to help them better understand how employees in the KYC function make decisions. Both de Vries and Scholten previously worked for the Dutch National Bank, a pioneer in the use of behavioral science for supervision.

"When we looked at the KYC process, you can design procedures and make sure the right people are involved, and that formal structures are in place to make the KYC process work," de Vries said. "But in the process, there are a lot of occasions where people really have to use judgment.

Sometimes they make it consciously, but also there are a lot of moments in the process when you make subconscious judgments."

Scholten and de Vries described how they work closely with employees to identify what kind of obstacles they face when performing their job. While some hurdles could be structural, often the problems were caused by personal biases. "For example, if I'm a bank employee and you are my client who I've known for 20 years, then I would probably feel that there is no risk of you being involved in money laundering," de Vries said.

"Bank employees that have to make a judgment on client files or cases may easily be subject to confirmation bias, where we simplify the information that we have to interpret by only looking for the kind of information that confirms our previous views."

"In-group, out-group" perceptions

Another issue is how KYC functions are structured at banks. For example, KYC employees at times may feel they are less valued than those in "front-office" roles. "What we do at different banks is analyze employees in different roles and what they have to go through in their work," de Vries says. "For instance, we look at motivation and targets, and what you may find is that a front office or a commercial department would have very strict or aggressive targets and also have a KYC target that would obviously be counterproductive."

Another part of their assessment includes looking at the resources KYC employees have available. For example, do employees have enough time to complete their tasks? What type of systems do they work with? If part of their work is outsourced, then what are the arrangements with these other departments?

At some institutions, the front office can be in one region, while the KYC unit is in another, leading to an "in-group, out-group" dynamic. "If you have a process that is outsourced or cut into several departments, and people have the idea that they have no influence at all on how they work or how the processes are affected, you will find there is a low level of self-efficacy that can lead to disengagement by employees," de Vries explains.

"Nudging" towards a more effective process

In describing how they worked with firms, Scholten explained there are three steps to the process. "Step one is a behavioral risk review where you identify categories of drivers and behaviors that impair money laundering or financial crime risk," Scholten says. "Step two is a behavioral insights scan where we identify the behavioral challenges and where you need to intervene or change; and step three is where you could use nudging or gamification to work with the onboarding teams and improve the KYC process."

In the case of a bank with its front-office and back-office in different regions, de Vries explains that a dashboard was created to make it explicit between the two groups who was working with whom. The dashboard, or nudge, was meant to enhance communication and improve collaboration.

"It's about stepping into the true motivation of people and trying to influence or mitigate the behavioral pitfalls that you have identified by small interventions," de Vries says.