

Unified, real-time Fraud + Anti-Money Laundering (FRAML) for a world of growing faster / real-time payments



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Real-time payments need to be backed up with real-time fraud and anti-money laundering measures. A unified real-time FRAML (Fraud + AML) approach helps financial institutions with a holistic framework to radically enhance financial crime risk management and operational efficiencies.



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The pandemic too has also impacted the way European users shop and pay, as their reliance on instant payments has increased.

Emergence of Real-time Payments and Instant Payments in Europe

Real-time payments are electronic payments that are settled virtually in real-time. The real-time payment landscape requires sub-second responses on transactions (allow / challenge / hold / decline / stop potential fraudulent transactions) on large volume transactions. These payment mechanisms provide speed, certainty, versatility and cost-effectiveness to consumers and merchants.

In the case of Europe, they are settled via the Single Euro Payments Area Instant Credit Transfer Scheme (SEPA SCT Inst.), a premium payment rail. As of today, Europe accounts for over half the global market for real-time payments.

The adoption of instant payments increased ten-fold between 2019 and 2021. What started in UK first in 2008, with the UK's real-time payments system named as Faster Payments System (FPS), has now reached millions. Most European markets, including the UK and the Netherlands, experienced significant growth in volumes and values of real-time payments in the subsequent years.

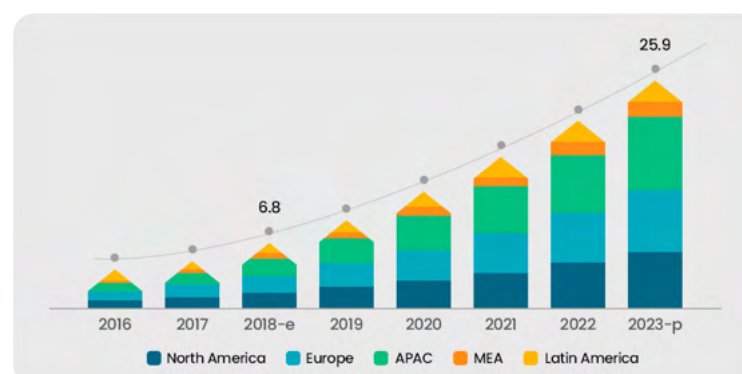
An initiative called P27 has been introduced in the Nordic region, spearheaded by Danske Bank, Handelsbanken, Nordea, OP Financial Group, SEB, and Swedbank. This anticipates the real-time payment market to grow significantly. The goal of the initiative is to offer an open access, ISO 20022 compliant infrastructure to facilitate domestic and cross-border real-time payments in multiple currencies. It includes Denmark, Finland, and Sweden.

The European Payments Council (EPC) has developed a pan-European instant payment scheme. This scheme's goal is to accelerate the development of real-time payments. It is based on the EPC's existing SEPA SCT. Moreover, this payment scheme enables Euro credit transfers with the funds made available on the account in less than ten seconds at any time and spans over 36 European countries.

In Germany, more than 75 percent of consumers have access to instant payments. Over 1,200 German payment service providers (PSPs) have signed up to SCT Inst., which is the highest in any EU country and accounts for more than half of the Eurozone total.

The Covid pandemic has also impacted the way European users shop and pay, as their reliance on instant payments has increased, and it is likely to grow in the coming years.

Real-time Payments Market, by Region (USD Billion)



Source - MarketsandMarkets

A recent survey by KPMG found that 67% of senior risk executives experienced fraud in the past 12 months and 38% expect the risk of fraud to increase in the next year.

Key Challenges the Financial Ecosystem will Face with Real-time Payments

By the end of 2022, several countries have adopted instant payment solutions. Real-time payments are no longer a matter of choice, but an expectation for consumers, merchants, and financial institutions to settle bills, transfer money immediately. This rapid adoption of instant payment technology also puts pressure on the infrastructure required to match these expectations. Even though instant payment solutions have grown over the years, financial institutions continuously face several challenges while creating this ecosystem.

To have a true, real-time payments interoperability and infrastructure, the ecosystem will face challenges of stunted global expansion, as instant payment solutions are a domestic concept. In Europe, the absence of synergy between systems is prohibiting global interoperability, and on average international bank transfers can still take anywhere up to five working days to complete.

The second challenge is connecting real-time payment systems to legacy systems, as they were designed to facilitate batch processing and lack the capability of processing each transaction separately.

The third and a more serious challenge is the concern of fraud and security with instant payments. The risk of loss with instant payments is greater than other types of transactions because of its instant nature.

A fraud risk management and AML framework, built to cater to legacy payment systems, is severely challenged in the case of instant payments – which demands real-time and synchronized financial crime detection.

Securing Digital Trust with Real-time Fraud Detection and Real-time AML Compliance

Financial Institutions constantly develop new innovations to enhance customer experience. Consumers in return readily adopt these with the confidence that they are fraud-proof. However, financial criminals continuously strive to discover chinks in the armour, thus demanding Financial Institutions to continuously fortify their innovations and systems.

It has been proven that AML and transactional fraud are correlated. FinCEN uses the term “predicate crime” that ties money laundering with transactional fraud. A predicate crime is a crime that is part of a bigger crime. Transactional fraud is often a predicate crime to money laundering. Addressing these two monsters separately is like wearing a blindfold in a wrestling match. Money laundering and transactional fraud, by looking for patterns using cohort analysis and predictive analytics in a synchronous fashion, vastly enhances detection efficiencies.

This enhances the ability to predict money laundering and at the same time, the information loop that is established, will help shut down transactional fraud much quicker and earlier in the fraud scheme.

This requires a shift from the conventional siloed fraud risk management and anti-money laundering compliance, towards an integrated and holistic approach to financial crime management. From a solution standpoint, Financial Institutions require a real-time platform robust in Transactional Fraud Monitoring, Enterprise Case Management and AML/CFT Compliance.

“The digital asset that matters is trust. Awareness first, then interaction, and maybe a habit, but all three mean nothing if they don’t lead to permission and trust. The privilege of connection. Everything else is slippery.”

– Seth Godin

Security, financial crime, resilience, fraud, loss prevention, operational risk, privacy, and data ethics are becoming increasingly intertwined in a digital and data-driven world. To counter this, a robust governance, risk, and compliance framework is vital to building and maintaining trust.

In order to innovate with speed and to gain trust, Financial Institutions must address the challenge with a unified vision and integrated solution approach, rather than a silo-ed one. This underscores the importance of a unified structure encompassing both real-time fraud detection and real-time AML compliance.

Market Drivers	Challenges To Respond To
Fraud typologies are increasing given the multitude of channels and customer options	Increased false positives leading to customer friction and operational costs
Real-time payment rails increase fraudsters and opportunists	Constant struggle to detect fraud in real-time
Rapid pace of change in AML guidelines expose banks to reputational loss and regulatory fines, besides constant pressure from regulators	Manual processes despite having an AML solution, difficulty in operationalizing new guidelines
Real-time payment rails increase options for money launderers to launder money faster	Constant struggle to detect money laundering schemes in real-time and extreme low latency
Traditional distinctions between fraud and money laundering are blurring	Silo-ed fraud and AML compliance solutions do not provide single financial crime view
Incomplete financial crime investigations without having a bigger picture of the crime	Non-availability of required information during financial crime investigations in silo-ed systems
Lack of synergy between departments dealing with fraud and money laundering issues and compliance efforts	Existence of numerous systems and multiple teams with non-transferable skill sets
Real-time payments – a growing reality across geographies	Real-time payments being a domestic concept hinders global interoperability

How Unified FRAML Can Help FIs

While the primary objective of the anti-fraud department is to prevent transactional fraud while reducing customer friction, and for the compliance department, it is detecting money laundering and ensuring regulatory compliance, at a larger institutional level there are certain key imperatives, i.e. shielding the organization from financial crimes (whether fraud or money laundering), improving efficiency and shrinking the cost for compliance of new channels and operating in accordance with regulations / legislations and protecting hard-earned organizational reputation..

Conventional fraud detection solutions are not designed to manage transactions at scale in real-time and are siloed or operating in batch mode. Regulators recommend combating financial crimes with a single platform that provides a real-time monitoring and prevention across multiple channels and product lines.

Advantages

- Reduced impact of financial crime on legitimate customers
- Improved efficiency at lower costs
- Financial crime risk operations in alignment with relevant legislation
- Single customer view for improved discovery
- Advanced analytics for fraud detection that can be applied to AML
- Economies of scale that reduce costs

Combining and analyzing the intersection between money laundering and fraud, financial institutions can effectively reduce false positives, increase the speed of customer onboarding, and better identify risk early in the customer lifecycle.

FRAML converges and synchronizes the activities and approaches of the anti-fraud and AML compliance departments. From a technology perspective, the shared goals are aligned with the FRAML solution technical architecture. Both teams can share the customer database, the same dashboard, the same case / alert management, and same rules engine, while independently conducting analyses according to their respective workflows.

There are several benefits in adopting a FRAML-driven approach for holistic financial crime management.

1. It improves discovery of the overall crime as it provides a single customer view that helps unravel the depth and breadth of the financial crime, providing a complete picture of the customer, using the same information. This provides enhanced visibility to the fraud risk and AML compliance departments and helps make quicker, better decisions and precise actions.
2. It reduces costs. Using the same or shared technical stack and architecture reduces TCO. Common building blocks between AML & fraud enable capex savings given the low maintenance costs of a single platform vis-à-vis two different systems. Common touchpoints with source systems help the bank to integrate only once. Maintenance costs are lowered whenever an update is required for the integration pieces. This also encourages the teams to learn skills common to each other based on the shared resources, providing flexibility on personnel management, also minimizing training costs.
3. The same advanced analytics used for fraud detection can be applied to AML systems. Real-time detection of money-laundering can be identified sooner than before by using the benefits of Artificial Intelligence and Machine Learning that are an integral part of anti-fraud technology.
4. It provides new technical capabilities to both teams as and when teams share their technology, they reinforce one another.

FRAML Powered by AI / ML

The objective of a unified solution is not just to pinpoint threats, but also to recognize the speed at which potential crimes are developing. Machine learning has been successful in fraud management by detecting fraud as it happens and due to regulatory pressures, it has increasingly become a necessity for AML compliance.

FRAML solutions combined with AI helps –

- combine and analyze vast amounts of data coming from various sources, from raw data to intelligent attributes. It serves two purposes – detect potential crimes, and predict and prevent crimes, because of the high level of information collected to create profiles.
- understand who the customers actually are, the potential threats they pose and help in detecting anomalies such as deviations in customer behaviour and transactions that are not physically possible based on location.

Conclusion

The rise of digital banking, faster / real-time payments and open banking have also created one of the biggest pain points for the banking industry – real-time fraud. Newer threats and an ever-changing regulatory landscape now demand more robust processes and innovative approaches to combat financial crime, while delivering frictionless customer experiences. Converging real-time Enterprise Fraud Management and real-time AML into a singular holistic unified real-time Fraud Risk + AML (FRAML) Compliance platform can therefore deliver powerful benefits to Financial Institutions.

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About the Author



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Pranjal is a product management expert and a senior member of the Clari5 product management team building real-time products that help financial institutions enhance their financial crime risk management capabilities. She is an MBA from the Department of Management Studies, IIT Delhi.

About Clari5

Endorsed Category Leader in Financial Crime Risk Management Systems for Enterprise Fraud by Chartis Research, winner of 'The Asian Banker's MEA Risk Management Award' and ranked consistently in Chartis' RiskTech100 rankings and quadrants, Clari5 redefines real-time, cross-channel banking Enterprise Fraud Management using a central nervous system approach to fight financial crime.

Harnessing the combined power of Automation, AI, Decision Sciences & Real-time Decisions, Clari5 is processing over 10 billion transactions, manages over 710 million accounts and reliably secures 4% of the global population's banking transactions. With 210 million accounts at a single site, Clari5 has the world's largest implementation of a fraud management solution.

Marquee banking customers across 24 countries who trust Clari5 for driving their fraud management strategy are recipients of global industry acclaim, including IBS Intelligence's Global Fintech Innovation Award and Celent's Model Risk Manager Award.

