WHITE PAPER

How to achieve regulatory compliance and exceed user expectations at the same time

Digital Account Opening

Consumers are more dependent on their digital devices to simplify and enrich all aspects of their lives anytime and anywhere. Shopping online, purchasing products, establishing relationships, and conducting business have advanced at an astonishing pace over the last decade with effortless user experiences at home or on the go.

While financial institutions (FIs) have made major investments in their mobile and online banking products to meet demand for easy to use services, heightened regulatory requirements since the terrorist attacks and the financial crisis have thwarted the efforts of many to achieve the same results with digital customer acquisition and onboarding. Most digital account opening applications offered by FIs are long, complicated, and require extensive data entry. An application that is difficult at best using a desktop browser is a non-starter using a mobile device, now the most commonly used method by consumers to go online.

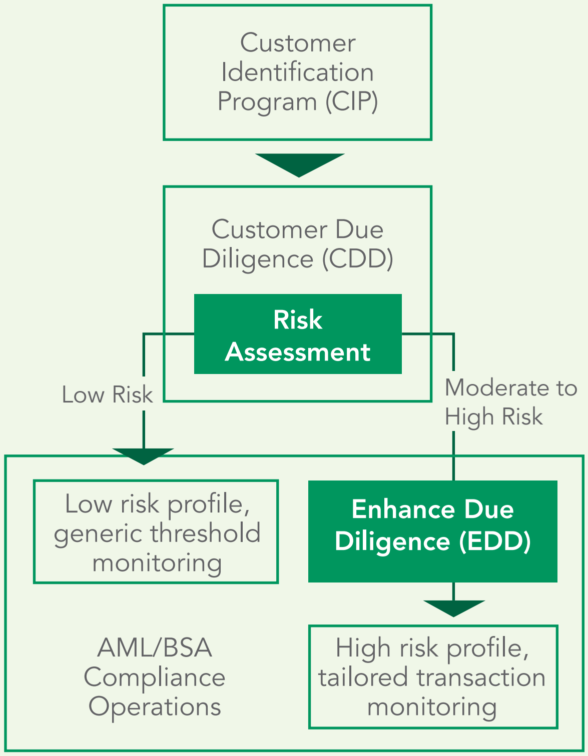
Escalating focus on compliance

Know Your Customer (KYC) provisions in the Patriot Act mandate collection of more information from customers and greater customer due diligence. The Dodd-Frank Consumer Financial Protection Act has heightened federal regulatory oversight of consumer banking products and requires financial institutions to be more vigilant in what and how information is communicated to consumers.

Given the unprecedented levels of regulatory oversight affecting new accounts for consumers, it comes as no surprise that financial institutions are grappling with digital account opening. The purpose of this white paper is to review the relevant regulations and share ways in which a financial institution can achieve compliance and exceed user expectations at the same time.

Know your customer

The underlying objective of Know Your Customer (KYC) is to reduce the possibility that a financial institution will be used for money laundering and terrorist financing activities. The KYC provisions in the Bank Secrecy Act and the Patriot Act create the regulatory obligation for FIs to follow prescribed methods to identify customers. Additionally, KYC extends beyond identify verification and includes performing Customer Due Diligence (CDD). If not handled appropriately, KYC requirements can be a source of significant friction and frustration for consumers in the account opening process. The regulatory guidelines do not mandate a one-size fits all approach to CDD but expect FIs to develop policies and procedures based on type of customer, customer location and the products they will use.The following diagram shows the major components of KYC.



Customer Identification Programs

The regulations require all FIs to have a Customer Identification Program (CIP). These programs include the institution's policies and procedures, by channel, for what information is to be collected during account opening and onboarding. The CIP is intended to enable an FI to form a reasonable belief that it knows the true identity of each customer. While CIP procedures may vary between FIs, the minimum information that must be collected during account opening includes; the customer's name, date of birth, physical address, and an identification number. Some of this information can be tedious to enter on a mobile device, yet consumers still expect to be able to complete the application process very quickly, typically in four minutes or less.

Compliance and streamlined data collection

More advanced digital account opening solutions maximize the features of the device to complete the account opening process, presenting the consumer multiple options to streamline the data collection process. These may include:

- Take a picture of the barcode on the back of the driver's license to autopopulate the consumer's name, address, date of birth, and ID number
- Utilize the current location as the recognized location via GPS as an option to populate the address
- Provide the option to integrate with the consumer's mobile carrier to autopopulate fields during the account opening process

Identity verification

FIs are further required to verify the identity information collected during the account opening process. The methods used to verify a customer's identify will vary by channel and should be documented in the FI's CIP. With digital account opening, where the consumer is not physically present, the regulations specify non-documentary methods of identity verification that an FI may use to meet these requirements.

Compliance and quick identity verification

- More advanced digital account opening solutions provide integration with identify verification services that check public and private databases for a match on the information provided and perform Office of Foreign Assets Control (OFAC) screening.
- Knowledge-based exams (commonly referred to as KBA) present questions generated in real-time from data records held by the identity verification service. Because, the knowledge needed to answer the questions is not available in a person's wallet ("out-of-wallet questions"), it would be difficult for anyone other than the actual identity to answer the questions correctly.
- Digital verification services can also be utilized to analyze the specific device used and environmental factors such as IP address to identify suspicious behavior.

Customer Identification Programs

The financial institution's CDD program outlines their policies and procedures for customer risk assessment. Bank examiners expect FIs to develop and use a framework for classifying customers based on the risk that a particular customer might conduct money laundering or terrorist financing.

At account opening, the FI should obtain sufficient information to develop an understanding of normal and expected activity for the customer. The FFIEC Anti-Money Laundering Examination Manual states "this understanding may be based on account type or customer classification"1; meaning, there is no explicit requirement to collect detailed anticipated account activity from individual applicants. For customers with a low risk classification, the FI may baseline a customer's expected transaction activity using transaction history from similarly profiled customers. For customers with a moderate or high risk classification, it may be more appropriate to use Anti-Money Laundering (AML) Operations to collect anticipated transaction details as part of Enhanced Due Diligence (EDD).

Consumer experience considerations

Unlike many other regulatory requirements imposed on FIs, KYC is not invisible to consumers. However, if approached carefully and thoughtfully with a mind to improve overall onboarding experience for both the customer and the FI, the institution can achieve compliance and exceed user expectations.

Compliance and targeted due diligence

- Remember there is a need to maximize the capabilities of the device being used to complete the account opening process for streamlined data collection.
- Integration to appropriate data sources and risk mitigation solutions is needed to improve the overall account opening process in as unobtrusive a manner as possible.
- Leverage technological advances in customer risk scoring models to minimize negative customer impact by collecting only the information necessary to support the customer risk assessment process.

The Dodd-Frank Act and UDAAP

The enactment of the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act of 2010 has had a profound impact on FIs and their consumer compliance programs. The Act states, "it is unlawful for any provider of consumer financial products or services or a service provider to engage in any unfair, deceptive or abusive act or practice"[2]. This concept is known as UDAAP for short. The Act does not provide detailed requirements for compliance rather it establishes a new agency, the Consumer Financial Protection Bureau (CFPB), with investigation, rulemaking, and enforcement authority to prevent UDAAP violations.

While some insights can be gleaned from the UDAAP examination procedures and institution guidance, the exact shape of UDAAP and its enforcement is still evolving. However, regulators do expect FIs to ensure every product and service takes UDAAP into account.

As part of the digital account opening deployment process, FIs are advised to identify possible UDAAP violations within the institution's advertising and marketing. Optimization of the presentation of disclosures during the new account opening process is also recommended.

Review Marketing and Advertising Materials. Product descriptions in marketing, advertising, and on the FI's website must be clear and easy to understand. The consumer should know what is being offered and what it costs. Materials should be formatted to direct attention to key information and disclose impacting or qualifying information.

Make Sure Free Means Free. Ensure that when marketing with the word "free" that the product or service is truly free of any and all fees. Otherwise, this will be considered deceptive. An account can be free, even if associated services are not free, as long as the services are not required on the account. Where different components of a service are free and others are not, ensure that ads and disclosures are extremely clear. For example – You can offer free online banking but charge a fee for bill pay.

Evaluate Disclosures. Review each product and service to ensure all related, proper disclosures are included. Disclosures should be overly clear so there is no question as to whether consumers can fully understand them. Even if an FI is in compliance with the model disclosure forms in Regulations DD, CC, E, P, RESPA, and others, this may not be sufficient for UDAAP purposes.

Compliance and fair practices

- More advanced digital account opening solutions allow the presentation of content appropriate to UDAAP including marketing descriptions and options for auxiliary services inside a storefront as part of the account opening process.
- Alternatively, integration from public web sites to the account opening process may be utilized to streamline the presentation of appropriate data and content and ensure the context of the interaction is not lost once checkout activities begin.
- Multiple products may be selected and applied for as well as optional product features in one process (for example, a membership and a loan or a checking account and a credit card) rather than requiring a bifurcated process with one product at a time where a consumer may only receive a fraction of desired value.
- A mechanism is provided to ensure receipt of required disclosures during the account opening process as well as ongoing access to these documents for further review after the process is complete.

The E-Sign Act

Congress enacted the E-Sign Act on June 30, 2000, to encourage and facilitate electronic commerce and, in doing so, created the legal basis for FIs to open accounts online without paper to follow. The Act allows information, which is required by law to be delivered in writing, to be delivered exclusively via electronic means, provided that the consumer consents to the information via electronic communications.

FIs are required to provide consumers certain account disclosures during the account opening process. New account disclosures my be provided to the consumer electronically, as long as the consumer consents to the institution's E-Sign disclosure and the consumer's consent complies with the requirements outlined in the E-Sign Act.

Failure to obtain consumer consent to electronic communications properly may significantly affect the FI's compliance with consumer laws and regulations, putting the institution in a weak position should there be a dispute with a customer.

Before obtaining the consumer's consent to electronic communications, an FI must provide the consumer a disclosure that includes the following:

- Informs the consumer of the option to receive the disclosures in a paper form and their right to withdraw consent.
- Specifies whether their consent applies only to this particular transaction (just the account opening transaction) or to identified categories of records (such as future account disclosures).
- Describes the procedures the consumer must use to withdraw consent and to update the information needed to contact the consumer electronically.
- Informs the consumer how to request a paper copy of a record and whether any fee will be charged for that copy.
- Provides the consumer with a statement detailing the hardware and software require-ments to access and retain electronic records.

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Also, the E-Sign Act includes specific requirements for how the FI obtains the consumer's consent to electronic communications. The act requires that consumers must provide affirmative consent electronically "in a manner that reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information that is the subject of the consent."3 This requirement is the most challenging of the E-Sign Act's rules because the FI must orchestrate consumer consent in such a way that proves the consumer is able to access and save the disclosures.

New account opening considerations of E-Sign

New account disclosures, such as those required by Regulation DD, CC, E, Z ,and P, must be provided to the consumer in a form they can retain before the new account can be opened. As previously described, new account disclosures can be delivered electronically provided an FI obtains the consumer's E-Sign consent properly. While the E-Sign Act allows for delivering disclosures electronically, it does not mitigate the other regulatory requirements related to the disclosure content and format. For example, the format and content of the new account disclosures should not be truncated. Given customers may access the account opening application from wide variety of devices, many of which have limited screen real estate, it is not practical to display disclosures within the online application.

Careful consideration should be given to the approach used to provide disclosures so that the regulatory requirements discussed are met and the process does not cause undue friction for the consumer. The following approach is designed to meet both criteria.

Compliance and clear disclosures

More advanced digital account opening solutions provide a mechanism to ensure receipt of required disclosures during the account opening process, as well as ongoing access to these documents for further review after the process is complete.

- Prior to sending the disclosures, the consumer's affirmative consent to receive disclosures electronically is obtained.
- The E-Sign disclosure and the account disclosures are sent via email to the applicant along with a one-time verification code.
- The applicant is required to enter the one-time verification code in the application to demonstrate they received the email and confirm they received the disclosures and agree to their terms and conditions prior to the account being opened.

By utilizing an approach such as the one outlined above, an FI is able to:

- Comply with the E-Sign Act's requirement for consent that reasonably demonstrates that the consumer can access information in the electronic form.
- Validate the applicant's email address is correct and that they are able to access emailed communications.
- Maintain compliance with format and content requirements for disclosures in a form the consumer can save or print.
- Not require the applicant to click on links to other web sites to review disclosures, reducing friction and the likelihood of abandonment.
- Enable a common approach for desktop and mobile account opening.

What about the signature card?

Over the years, signing a signature card became synonymous with opening a bank account. While still commonly used in the branch new account process, the purposes served by the signature card can be addressed without paper in digital account opening.

The primary purpose of the signature card is to enable the account holder(s) to confirm receipt of the requisite new account disclosures, accept the terms and conditions of the account agreement, and to provide a signature specimen.

Historically, banks used the signature card to verify an account holder's signature on checks presented for payment at a branch or through clearing. Today, more sophisticated risk-based technology tools are used to detect forgeries. In a situation where a signature specimen is required for comparison, FI operations will likely look at the account holder's signature on recent low-dollar checks paid on the account.

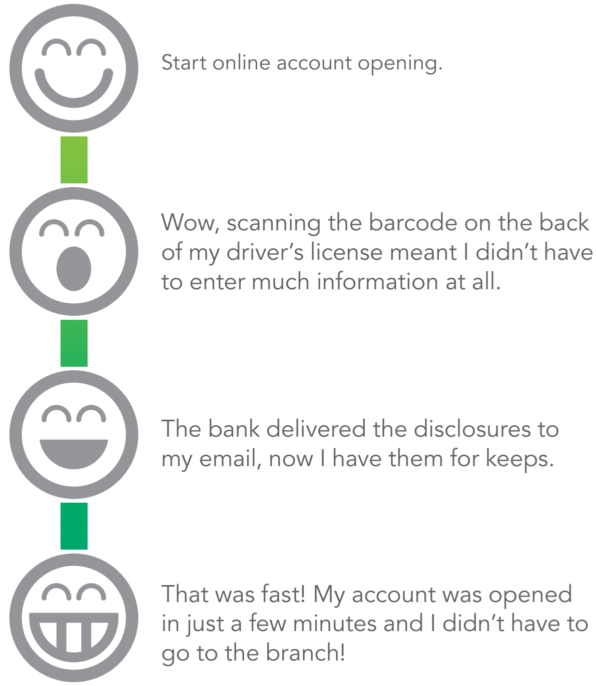
Compliance and convenience

- Once the consumer consents to the FI's E-Sign disclosure, the institution may use a checkbox to get the account holder's confirmation of receipt of disclosures and acceptance to the terms of the account agreement. This avoids the nuisance of the signature card.
- More advanced digital account opening solutions provide the option to collect a digital signature specimen through touch-enabled digital devices with high quality.

Conclusion

FIs are under intense pressure to grow revenue and improve profitability, and it is widely accepted that success in digital channels is imperative to meet these objectives. The current regulatory environment places a few speed bumps for those institutions pursuing digital customer acquisition and onboarding.

However, by following the suggestions provided in this whitepaper, FIs can in fact implement required compliance requirements in a way that also exceeds customer expectations.



About Q2 Gro

Q2 Gro provides digital growth solutions for banks and credit unions. Through a fresh direction and a technology strategy that embraces mobile capabilities instead of begrudgingly accommodating them, Q2 Gro helps FIs meet and exceed the mobile expectations of a new customer.

For more information, go to Q2.com or call (833) 444-3469.