

A SURVEY E-BOOK BY COMPLIANCE WEEK

Financial institutions
NAVIGATE FORWARD
by outsourcing compliance

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COMPLIANCE WEEK

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Founded in 2002, Compliance Week has become the go-to resource for chief compliance officers and audit executives; Compliance Week now reaches more than 60,000 financial, legal, audit, risk, and compliance practitioners. www.complianceweek.com



Guidehouse is a leading global provider of consulting services to the public sector and commercial markets, with broad capabilities in management, technology, and risk consulting. By combining our public and private sector expertise, we help clients address their most complex challenges and navigate significant regulatory pressures focusing on transformational change, business resiliency, and technology-driven innovation. Across a range of advisory, consulting, outsourcing, and digital services, we create scalable, innovative solutions that help our clients outwit complexity and position them for future growth and success. The company has more than 16,500 professionals in over 55 locations globally. Guidehouse is a Veritas Capital portfolio company, led by seasoned professionals with proven and diverse expertise in traditional and emerging technologies, markets, and agenda-setting issues driving national and global economies. For more information, please visit www.guidehouse.com.

Financial institutions doing more with less by outsourcing compliance

Respondents to a recent survey conducted by Compliance Week and Guidehouse largely indicated outsourcing improved the effectiveness of their compliance program in fighting financial crime, though limits remain on how much can be outsourced.



BY AARON NICODEMUS, COMPLIANCE WEEK

Three out of four financial services firms that chose to outsource portions of their financial crime compliance function reported they were pleased with the results, according to a new survey conducted by Compliance Week and financial services consultancy Guidehouse.

The survey of 247 compliance professionals working at banks, financial technology firms (fintechs), cryptocurrency firms, and nonbank financial institutions (NBFIs) found 26 percent of respondents were currently outsourcing, while 14 percent were considering outsourcing.

Among those who outsourced, 74 percent felt it improved the effectiveness of their compliance program in fighting financial crime. Another 18 percent reported no change in effectiveness, while 8 percent said their compliance efforts “went backwards” after outsourcing.

Respondents who said their firms outsourced indicated they did so most often to reduce costs while meeting regulatory expectations (65 percent), followed by firms that preferred to focus on core competencies and better utilize internal resources (45 percent). Forty percent said they outsourced to improve deficient, ineffective, or inefficient processes, while 35 percent said they wanted to develop a flexible staffing model. Respondents were told to choose as many answers as applied.

Eli Morillo, partner at Guidehouse, said some financial institutions “find it more effective and more efficient to outsource a function on a long-term basis. Leveraging offshore locations

also can reduce costs and provide a ‘follow the sun’ model with round-the-clock coverage.”

“Regulators are being more aggressive with their enforcement efforts, and that focus has the potential to add strain to an organization’s compliance efforts,” added Jay Perlman, client relationship executive at Guidehouse. “Outsourcing provides an opportunity to reduce this burden without disrupting

What is outsourcing compliance?

The financial services industry is one of the largest buyers in the multi-billion-dollar global outsourcing market, which is expected to continue to rise and exceed \$335 billion annually by 2024. As these organizations reimagine compliance operating models to focus resources on driving growth and competitive advantage, managed services partners are a key lever in this transformation. Best-in-class compliance partners help financial institutions unlock compliance program efficiencies and reduce the cost of compliance while maintaining program effectiveness.

—Guidehouse

business as usual.”

Firms already outsourcing were much more likely to be small to mid-sized institutions (75 percent) with less than \$60 billion in assets, according to the survey results. Among those who indicated their company outsourced components of its compliance function to fight financial crime, 45 percent worked at an NBFI (e.g., money services business, money transmitter, broker-dealer, investment company); 29 percent worked for a bank; 23 percent worked for a fintech; and 3 percent worked in the crypto space.

Pros and cons of outsourcing compliance

Morillo noted small firms, fintechs, and crypto asset companies might lack the expertise in a particular compliance area or not have enough full-time employees on hand to meet increasing demand. Outsourcing allows firms to “ramp up and ramp down, depending on the volume of business,” he said. Another advantage is outsourcing avoids the fixed costs that come with full-time employees.

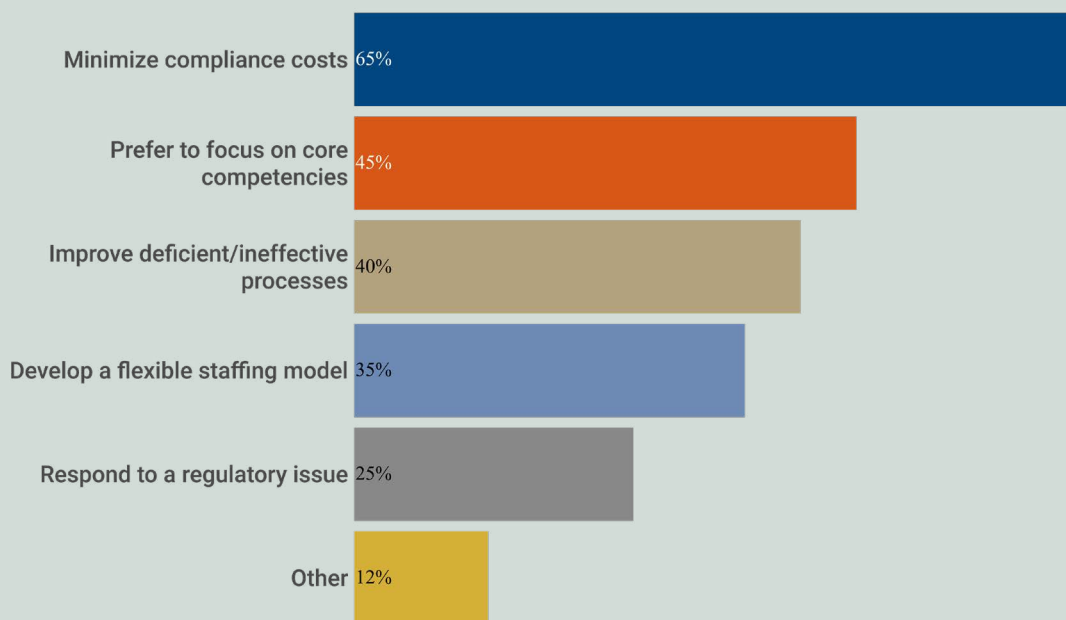
The biggest challenge reported by firms that outsourced was the initial costs and resources needed to onboard an outsourcing partner (37 percent), the survey said, followed by an

“Outsourcing components of a compliance function can allow businesses the ability to maintain their competitive footing while also remaining current with evolving regulatory demands.”

Ali Bokhari, Global Managed Services Leader and Partner, Guidehouse

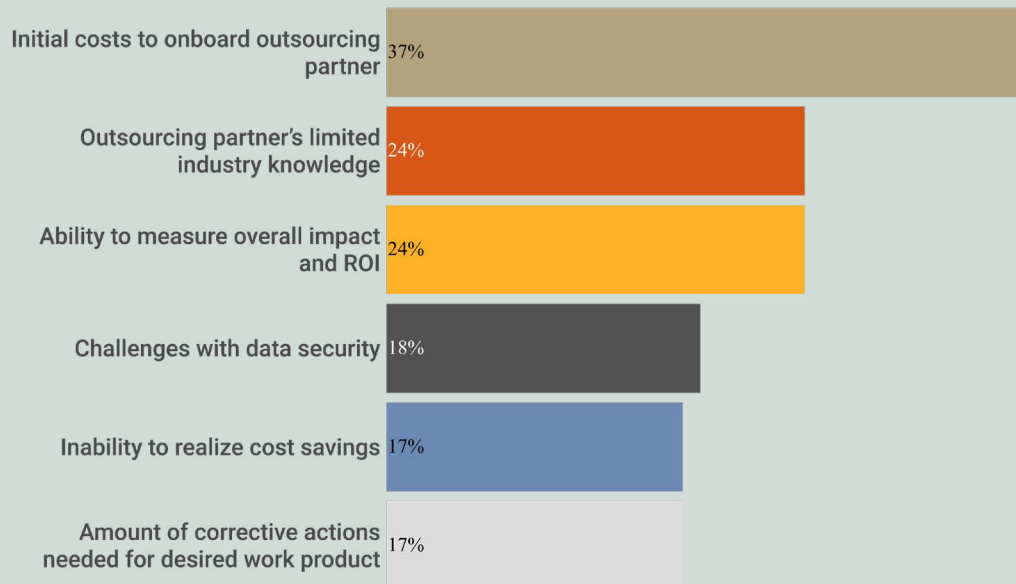
outsourcing partner’s limited industry knowledge (24 percent) and the firm’s ability to measure overall impact and return on investment (24 percent). Challenges with data security, inability to realize cost savings, amount of corrective actions to achieve desired work product, responsiveness of the vendor, and limited knowledge of local mandates and fragmented policy environments all received response rates of more than 15 percent. Respondents could choose up to four answers.

What prompted you to seek an outsourcing provider? Select all that apply.



What were the biggest challenges you faced when outsourcing components of your compliance function?

Select up to four.



Regulatory perspective

Firms considering outsourcing portions of their compliance function must understand the expectations of their regulators, including industry-specific regulators.

“While outsourcing with proper safeguards and controls is generally accepted by regulators, it’s important to note financial institutions cannot outsource everything. Regulators expect there to be some oversight,” Perlman said. All major decisions—i.e., whether to conduct an investigation based on an outsourcing company’s analysis and the filing of a suspicious activity report or other regulatory filings—should rest with the company itself.

If a firm chooses to outsource certain compliance functions offshore, regulators generally expect the decision-making process would remain in the United States with the financial institution, Morillo said.

Another hurdle to overcome to successfully outsource a compliance function is ensuring the security of a firm’s sensitive data. One well-established outsourcing model allows an outsourcing firm to access a financial services firm’s data through a secure connection in which the data remains in the client’s servers, Morillo said. There would also be physical security protocols in place for the outsourc-

ing team members who accessed the firm’s network, he said.

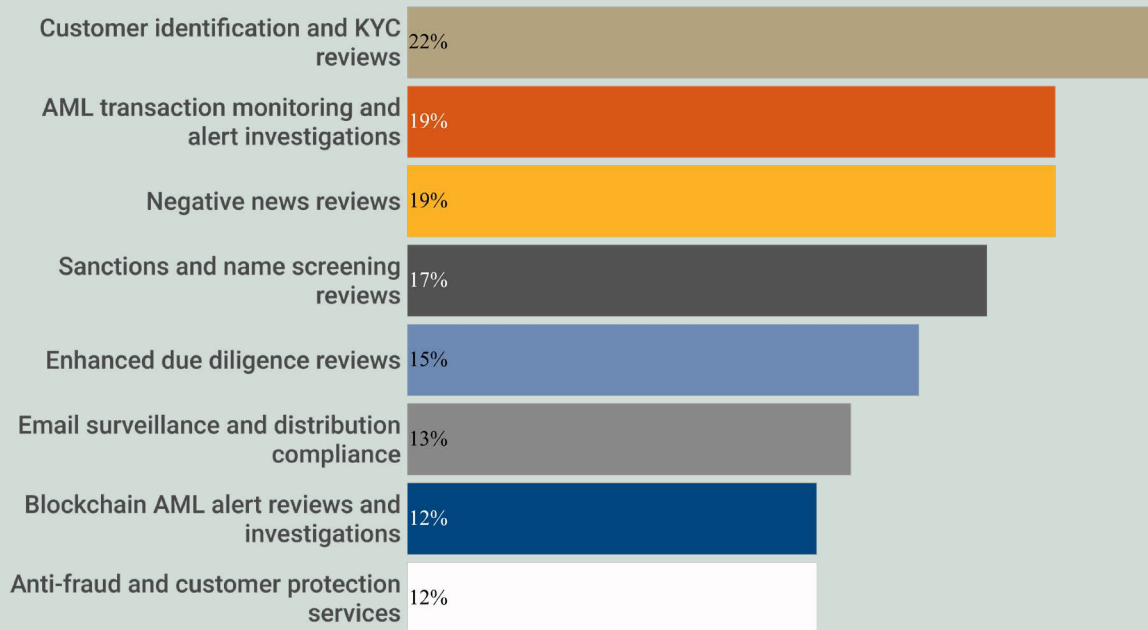
What goes into the choice to outsource?

Of the 13 percent of respondents who said they were considering outsourcing, opportunity areas cited included customer identification and know your customer reviews (22 percent), anti-money laundering transaction monitoring and alert investigations (19 percent), negative news reviews (19 percent), and sanctions and name screening reviews (17 percent). Respondents could choose as many categories as applied.

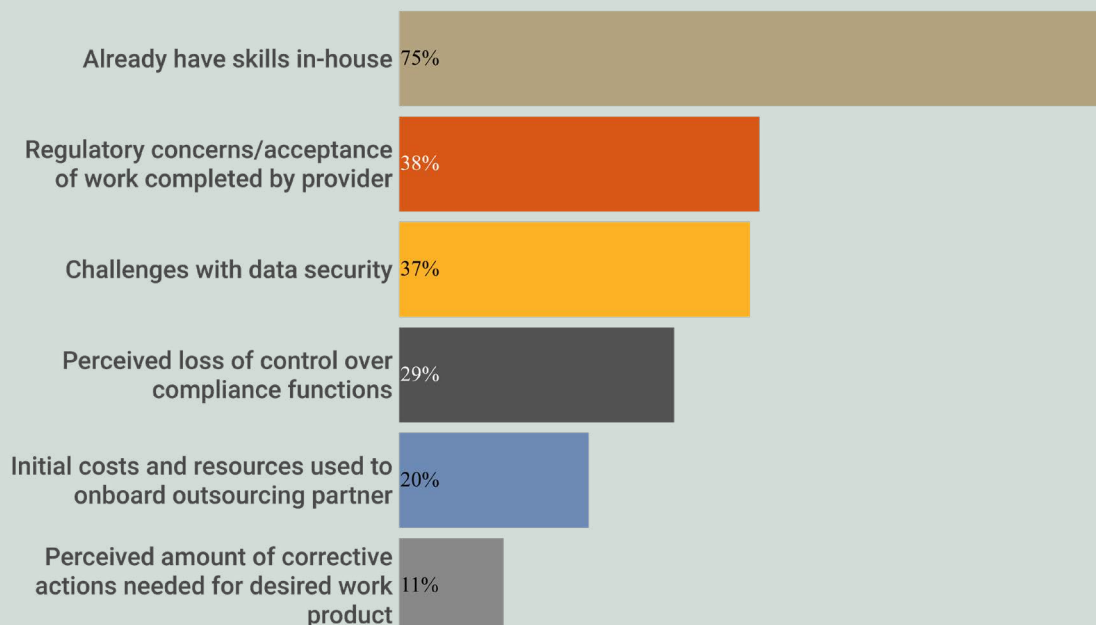
Of the remaining 60 percent of respondents who said their firms were not currently outsourcing, the most popular reason (75 percent) was they felt their firms already possessed the necessary skills in-house. Other reasons included regulatory concerns (38 percent), challenges with data security (37 percent), and perceived loss of control over compliance functions (29 percent). Respondents could choose up to three answers.

“Many firms are afraid to disrupt business as usual,” Morillo said. “Or they may be so small that their volume of transactions doesn’t warrant it.” ■

Which of the following areas might you consider outsourcing? Select all that apply.



Why isn't your organization contemplating outsourcing any components of financial crime compliance? Select up to three.



Navigating the Complexities of Financial Crime Compliance

Proactively managing financial crime compliance is essential in an ever-evolving regulatory — and risk — landscape.



The compliance landscape has become increasingly complex in recent years across many industries. For some sectors, such as financial services, healthcare, and energy, sustainability, and infrastructure (ES&I), the compliance environment, particularly around financial crime compliance, has become exponentially challenging.

While these industries have always been subject to rigorous compliance standards, the evolving complexities around digital asset security, remote work,

environmental regulations, digital payments, and more have added to compliance officers' burden.

Financial crime compliance and monitoring is a particular area of increasing concern as cybercriminals continually evolve their tactics to stay ahead of financial institutions, regulators, and consumers. AI-enabled voice fraud, for example, has risen so quickly that government agencies haven't even begun to gather data on the trend.¹

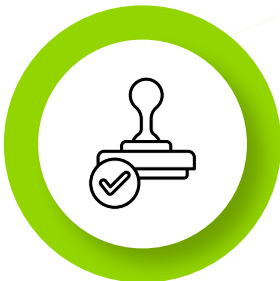
Just as the fraud landscape is rapidly evolving, the need to access specialty expertise for a diverse range of compliance priorities has never been in higher demand as staffing shortages compete with budget mandates and economic realities.

To navigate these complex demands, many firms are outsourcing portions of their compliance programs to effectively and efficiently outmaneuver these complexities.

A recent survey conducted by Compliance Week and Guidehouse found that of the 26% of financial institutions that reported outsourcing, 74% felt it improved the effectiveness of their compliance program in fighting financial crime. Outsourcing components of a compliance function can allow businesses the ability to maintain their competitive footing while also remaining current with evolving regulatory demands.

Firms Outsource These Key Compliance Functions:

Regulatory Compliance



Experts help assess risks and requirements, then implement the processes, procedures, and people to remediate and manage them.

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Risk Management



Industry expertise and AI-powered analytics help organizations respond to risk and use it as a catalyst for organizational transformation.

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Financial Crime, Fraud & Investigative Services



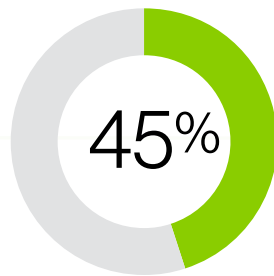
Financial crime compliance experts help organizations cover the bases of the governance ecosystem, ranging from financial compliance and global investigations to enforcement.

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Financial Fraud Challenges on the Rise

Financial institution compliance in the modern world requires leveraging ever-evolving tools and models to stay ahead of perpetrators. The adoption of machine learning, for example, is positioned to explode as a method of fighting financial crime, requiring financial institutions to understand and invest in the technology wisely as it becomes more effective and efficient as products mature.

Another example of financial institutions' evolving needs involves how they manage customer risk ratings (CRR). Many institutions rely on the traditional scorecard model, which can result in inconsistent customer risk assessments based on subjectively determined scores. More advanced regression models can reduce subjectivity from the CRR by processing data through a mathematical framework and generating the expected rating of the customers based on a broad set of risks. While this approach is relatively more difficult to develop and update than the scorecard model, it provides more consistent risk ratings.



of outsourcing financial institutions reported doing so to focus on core competencies and better utilize internal resources according to the Guidehouse and Compliance Week survey.

Monitoring, assessing, and implementing these and many other new and emerging financial crime tools and models is a complex task. Organizations must be proactive to stay ahead of the challenge. Financial institution compliance, in particular, requires constant monitoring, regular automated vulnerability assessments, and implementing a fraud technology orchestration strategy, in which customized anti-fraud technology targets specific potential weaknesses across all the organizational processes.

Outsourcing providers can support financial institutions' compliance and monitoring programs in this complex environment. Deep subject matter experts allow large organizations to stay nimble, reacting quickly to changing financial fraud tactics and regulation changes, as well as embracing the best technology and strategies to remain competitive.

The need to tap outside expertise emerged as a significant motivator for financial institutions that outsource compliance functions. In the Guidehouse and Compliance Week survey, 45% of outsourcing financial institutions reported doing so to focus on core competencies and better utilize internal resources.

A Fast-Evolving Regulatory Landscape

While security and financial crime compliance garner headlines, regulatory changes — ranging from the U.S. Securities and Exchange Commission's market structure agenda to new and forthcoming regulations meant to

address climate change and its related financial risks — present organizations with challenges as well.

One forthcoming set of new regulations for financial institutions is from the Financial Crimes Enforcement Network (FinCEN). FinCEN is expected to announce how it will implement the Corporate Transparency Act (CTA) in the near future. Despite FinCEN publishing responses to some FAQs in late 2022, many unanswered questions remain regarding the three components of the CTA: Beneficial ownership information (BOI) reporting requirements, BOI Access and Safeguards requirements, and revisions to the 2016 Customer Due Diligence requirements for covered financial institutions.

While complete information on the CTA's most significant impacts on financial institution compliance may not be available until 2024, compliance officers should already be taking action to prepare for the unknown, from establishing internal communications to assessing the organization's technology needs to comply with developing CTA requirements.

For many organizations, outsourcing those functions is critical to success in preparing for and, ultimately, complying with regulatory standards that are both forthcoming and unknown. Outside compliance experts help firms identify and prevent problems beforehand so they can have a more complete, accurate, and real-time view of their risks with confidence. The desire to achieve those outcomes was clear in the Guidehouse and Compliance Week survey. Among outsourcing firms, 65% reported doing so to reduce costs while meeting regulatory expectations — the most common reason for outsourcing cited in the survey.



Compliance Outsourcing in Action

Guidehouse helped a large bank implement a robust regulatory change-management program.

CHALLENGE

A large bank needed to address a regulator-mandated effort to assess the existence of policies, procedures, and controls to conduct, oversee, and monitor banking operations under regulatory obligations.

SOLUTION

The Guidehouse Managed Services team designed and implemented a sustainable regulatory change management process and web-based tool to perform a compliance review covering thousands of regulatory requirements.

IMPACT

In addition to the hundreds of resources that performed the expedited compliance review, we also helped the company establish a sustainable process for demonstrating compliance with the laws and regulations governing the business moving forward.

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Outsourcing with a Trusted Compliance Partner

In an ever-evolving world of financial crime, technology development, and regulatory changes, organizations must proactively manage the complexity of compliance requirements. Doing so while controlling costs is a challenging endeavor.

With 40% of financial institutions in the Guidehouse and Compliance Week survey reporting they were either outsourcing or considering outsourcing portions of their compliance function, it's clear that tapping outside expertise is becoming increasingly common. Many organizations in sectors such as healthcare and ES&I are effectively leveraging outsourced compliance management as well.

Working with a trusted outsourcing provider that brings deep industry expertise to the relationship is critical to success in outsourcing compliance functions. Compliance experts can help identify and prevent compliance and monitoring problems before they arise, giving organizations a more complete, accurate, and real-time view of their risks. ■

Resources

1. Caroline Mimbs Nyce, "It's Time to Protect Yourself From AI Voice Scams," April 27, 2023, The Atlantic, <https://www.theatlantic.com/technology/archive/2023/04/ai-voice-cloning-imposter-scams/673879/>.

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About Guidehouse

Guidehouse is a leading global provider of consulting services to the public sector and commercial markets, with broad capabilities in management, technology, and risk consulting. By combining our public and private sector expertise, we help clients address their most complex challenges and navigate significant regulatory pressures focusing on transformational change, business resiliency, and technology-driven innovation. Across a range of advisory, consulting, outsourcing, and digital services, we create scalable, innovative solutions that help our clients outwit complexity and position them for future growth and success. The company has more than 16,500 professionals in over 55 locations globally. Guidehouse is a Veritas Capital portfolio company, led by seasoned professionals with proven and diverse expertise in traditional and emerging technologies, markets, and agenda-setting issues driving national and global economies. For more information, please visit www.guidehouse.com.



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Lighting the Way for Our Clients to Lead the Way

Fighting corporate fraud and investigating financial crime while maintaining regulatory compliance in an evolving market is highly complex. It requires a trusted guide with deep experience so you can focus on growing your business. Guidehouse outsourcing resources supplement your staff to create customized strategies and solutions. Helping mitigate your risk while maximizing your operational resiliency.

outwit complexity™