Addressing Key AML Challenges for Securities and Investment Firms

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It's easy to underestimate the burden that money laundering and its compliance requirements place on securities and investment firms. The nature and complexity of business transactions creates a wealth of opportunities for money launderers. Keeping up with this threat can be costly.

By developing comprehensive AML programs and taking advantage of advanced technologies, however, securities and investment firms can minimize their risk and meet rigorous compliance requirements while maintaining operational efficiency.

Securities and investments firms are an irresistible target for money launderers. According to the Financial Action Task Force (FATF) in its October 2018 Guidance For A Risk-Based Approach, Securities Sector report, the complexity, internationality, high volumes, speed and anonymity of securities transactions create ideal opportunities for financial crime to occur.

Criminals launder money through securities and investments in a number of ways, such as:

- Structuring transactions to avoid transaction monitoring/reporting thresholds
- Carrying out simultaneous sells and buys in the same financial instrument, with no concern for financial gain
- Transferring funds or securities into an account and subsequently transferring the same or similar amounts out of that account
- Trading penny stocks in unusual volumes
- Changing the beneficiary or ownership of an account following a large payment

Without the proper controls in place to detect and prevent money laundering, securities and investment firms leave themselves vulnerable to savvy criminals. Regulatory compliance, reputation and business integrity are at risk when a money laundering scheme goes undetected.

Fines for noncompliance with AML regulations are just the beginning. When news about a money laundering scheme goes public, reputations and brands are damaged. How can investment clients trust a firm that, knowingly or not, did business with criminals?

According to the United Nations Office on Drugs and Crime, the estimated amount of money laundered globally is two to five percent of global gross domestic product, or between $800 billion and $2 trillion per year.

Reducing Risk While Increasing Efficiency

Firms must weigh the risk of undetected money laundering with the operational impact of a cumbersome manual detection effort. Increasing headcount or adding manual reviews that slow down the business isn't a realistic answer. Securities and investments firms must remain efficient and responsive to clients' needs.

The answer lies in developing a comprehensive anti-money laundering (AML) program supported by the most effective technology for financial crime detection. Here are three key areas of focus to meet these challenges.

1. Implement a Risk-Based Approach

Evaluate your AML program to make sure you are focusing your detection and control efforts where your firm is most vulnerable to money laundering (known as a risk-based approach). This enables a more effective, efficient and compliant program.

According to the FATF report, a risk-based approach to AML means that firms are expected to identify, assess and understand the money laundering risks to which they are exposed and take AML measures commensurate to those risks to mitigate them effectively.

Steps to setting up a risk-based approach include:

Allocate Responsibility

An effective risk-based plan builds on and reflects a country's legal and regulatory strategy, the nature, diversity and maturity of its financial sector and its risk profile.

Identify Risk

Access to accurate, timely and objective data about money laundering risks is a prerequisite for an effective AML program. Where data is not readily available, it will be difficult for firms to correctly identify, assess and mitigate money laundering risk.

Assess Risk

Firms should determine how the identified money laundering threats will affect them. Firms should understand the likelihood of these risks occurring and the impact that they would have on the organization

Mitigate Risk

When applying a risk-based approach, firms should decide on the most effective and appropriate way to mitigate the money laundering risk identified. They should take enhanced measures to manage and mitigate situations in which the money laundering risk is higher; in low-risk cases, they should apply exemptions or simplified actions.

How Technology Supports

The right technology platform can support a risk-based approach by assessing all pertinent data and assigning a risk score to each transaction. Risk scores are generated based on risk profiles that factor in characteristics such as the client's exposure to sanctions, country of domicile, product type and account values.

In addition to enabling firms to take quick action on high-risk situations, risk scores allow firms to immediately respond to regulatory requests to show the highest risk relationships. Each risk score and profile is monitored on an ongoing basis and updated with any changes in the subject's characteristics or behavior. Risk scores also inform detection scenarios, ensuring that high-risk activities are investigated first.

Data should be managed through a robust and flexible data integration architecture in the AML solution that provides secure data transmission, secure record-keeping and a method for data reconciliation, anomaly detection and reporting.

Case-in-Point

In 2019, the Financial Industry Regulatory Authority (FINRA) fined BNP Paribas Securities Corp. and BNP Paribas Prime Brokerage Inc. $15 million for failures in AML programs and for supervisory failures that involved penny stock deposits, resales and wire transfers that spanned four years. BNP did not develop and implement a written AML program that could reasonably be expected to detect and cause the reporting of potentially suspicious transactions.

2. Provide Fast, Accurate and Compliant Onboarding

Smooth and successful client onboarding is more important than ever. As competition in the securities and investments industry heats up, many firms are acquiring new clients and increasing wallet share from existing clients to drive growth. These strategies center on improving the client experience at each touchpoint throughout the customer life cycle, with a strong emphasis on the first interaction – client onboarding.

Onboarding speed, accuracy and compliance provide a significant advantage over industry peers and allow for rapid expansion into new markets. However, onboarding new clients as a regulated company can be complex. Legal entities can be used to facilitate money laundering and other crimes because their true ownership can be concealed. Under the Financial Crimes Enforcement Network's (FinCEN) Beneficial Ownership Rule, a firm must create and maintain written procedures reasonably designed to identify and verify beneficial owner(s) of legal entity customers and to include such systems in its AML compliance program.

Firms must establish and maintain documents detailing the identifying information (such as name, date of birth and Social Security number) and financial circumstances for each beneficial owner of a legal entity client opening a new account.

Beneficial ownership and related requirements such as Customer Identification Program (CIP) and Customer Due Diligence (CDD)/Enhanced Due Diligence (EDD) should not delay new business onboarding, yet legacy systems and manual steps can slow the process considerably.

How Technology Supports

Key solutions to meet these requirements include automated watch list filtering and sanctions screening, customer profiling and know your customers (KYC) questionnaires.

Watch list filtering technology screens customer and vendor data against sanctions and politically exposed persons (PEP) lists as well as custom lists and those provided by third-party data service providers. Watch list filtering supports regulatory compliance with organizations like the Office of Foreign Assets Control, Office of Superintendent of Financial Institutions and United Nations.

Configurable KYC questionnaires in an AML solution facilitate the capture of the information required to build accurate client profiles and risk scores for initial due diligence, enhanced due diligence and ongoing transaction behavior and risk monitoring.

With automated solutions such as these, onboarding takes much less time and effort while increasing accuracy in assessing risk.

Case-in-Point

In 2018, FINRA fined Industrial and Commercial Bank of China Financial Services LLC (ICBCFS) $5.3 million for systemic AML compliance failures, including its failure to have a reasonable AML program in place to monitor and detect suspicious transactions, as well as other violations, including financial, recordkeeping and operational violations.

3. Balance Program Costs With Reduced Risk

According to the 2018 Global Anti-Money Laundering and Sanctions Compliance Survey by Alix Partners, compliance executive respondents reported that the cost of AML

and sanctions compliance has been increasing and will continue increasing as new challenges emerge. A majority (59 percent) consider their AML and sanctions compliance budgets inadequate or severely inadequate. Compliance executives said they worry about the adequacy of their budgets and the allocation of their personnel.

As compliance departments struggle to keep pace with the digital transformation of financial services, firms must invest strategically in technologies designed to control costs and increase productivity through improved operational efficiency.

How Technology Supports

Monitoring large and complex data sets is nearly impossible to do manually. A comprehensive AML solution can provide automated monitoring, alerting and reporting capabilities that allow compliance departments to prioritize their efforts and focus on real threats while improving efficiency and managing costs. An AML solution can sift through large volumes of client and transaction data to detect and report suspicious activity – helping the firm meet regulatory requirements and minimize exposure. It can also reduce the number of false alerts that take up valuable investigation time.

A configurable analytics engine combined with best-practice detection scenarios can help securities firms automatically monitor internal and external activity for red-flag behavior, improving both productivity and compliance.

Time-saving capabilities for reporting can include preconfigured templates for specific regulatory reports, such as suspicious activity reports/suspicious transaction reports that are auto-populated with case details and can be electronically filed for those jurisdictions with e-filing requirements. This also improves compliance.

Meeting New Challenges

Today, money moves around the world with greater speed and ease than ever before. Rapid advances in technology have turned the financial infrastructure into a perpetually operating global ecosystem.

This increasingly complex environment demands continued innovation with regard to risk management and regulatory compliance. By taking advantage of advanced AML technologies, securities and investment firms can overcome the limitations of outdated systems and manual processes while meeting the expectations of both clients and regulators.

Case-in-Point

In 2018, FINRA fined Morgan Stanley Smith Barney LLC $10 million for anti-money laundering (AML) program and supervisory failures that spanned a period of more than five years. FINRA found that Morgan Stanley's AML program failed to meet the requirements of the Bank Secrecy Act because its automated AML surveillance system did not receive critical data from several systems, undermining the firm's surveillance of wire and foreign currency transfers; it failed to devote sufficient resources to review alerts generated by its automated AML surveillance system; and it did not reasonably monitor customers' deposits and trades in penny stock for potentially suspicious activity.

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Fiserv, Inc.
255 Fiserv Drive
Brookfield, WI 53045
www.fiserv.com

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