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Is Your Firm a Leader at Detecting Money Laundering?

As each year goes by the world becomes more and more complex. With respect to the investment management industry we can point to many topics. Included in that list is the topic of money laundering. Regulators have made inroads at heightening prevention. However, they have no time to rest on their laurels as criminals will stop at nothing to continually enhance their sophistication. So long as crime is highly profitable (i.e. "crime pays") it will exist and expand. What is money laundering? How can a securities dealer enhance its AML compliance program? Which firms are most vulnerable? This article will attempt to touch on each.

What is Money Laundering?

Fintrac defines money laundering as "the process used to disguise the source of money or assets derived from criminal activity (i.e. drug trafficking, smuggling, fraud, extortion and corruption)". Money laundering facilitates corruption and can destabilize the economies of susceptible countries. It also compromises the integrity of legitimate financial systems and institutions, and gives organized crime the funds it needs to conduct further criminal activities. Sophisticated criminals are making it increasingly possible to obscure the money trail leading back to the underlying crime.

Enhancements to Security Dealers' AML Program

Security dealers should ensure that their AML compliance programs possess the following:

1. Perform thorough due diligence of all clients inclusive of a comprehensive risk assessment.
2. For corporate clients, institutions and third parties, ensure the documentation of the beneficial owners and controlling persons.
3. Establish "high-risk" criteria, identify clients that would be classified in that category, and ensure that an enhanced due diligence (EDD) performed on them. High-risk clients can include politically exposed persons as well as those living abroad in "high-risk" countries.
4. All clients must be monitored on an ongoing basis and any deviations in each client's individual trend should be documented with the goal re-classifying risk category if required.
5. Ongoing training must be performed so staff can know what to look for as well as keep up to date with heightened complexities of criminal money laundering schemes as well as initiatives securities dealers are required take in order to combat it.
6. Internal record-keeping must ensure that securities dealers meet their regulatory reporting requirements. Most notably, controls should be in place to properly flag: suspicious transactions, large cash transactions, electronic fund transfers and terrorist reporting lists.

David or Goliath: Who is Most at Risk?

The larger the entity the greater the challenge it is to ensure consistent adherence across the organization. All it takes is one bad apple to spoil the lot. As a sheer numbers game, large organizations are more susceptible to being infiltrated by bad apples as large transactions are more commonplace thus appearing less suspicious. AML audits for large firms are best to be performed by those with actual experience at implementing AML programs for similar-sized firms. In reality, the lack of qualified people performing these audits is abundant.

Concluding Remarks

Security dealers need to continually meet increasingly demanding regulatory requirements. Indeed, they can perform an AML audit internally. However, the best policy is to engage with an entity whose principals know and understand security dealers' compliance programs and AML control environment because they themselves have performed those same tasks for firms of similar or greater complexity. Industry participants should be weary of entities with well-known brands that masquerade as AML specialists when in fact the firm as a whole and especially the juniors that perform the actual work are great at charging hefty fees but not so great at providing additional value to security dealer AML control programs.