



cutting through complexity

# Managing financial crime risk in Investment Management

November 2013

[kpmg.co.uk](http://kpmg.co.uk)





## Contents

<b>Introduction</b>	3
<b>KPMG's multi-disciplinary approach</b>	4
<b>KPMG's service offerings</b>	6
<b>Anti-bribery and corruption</b>	7
<b>Anti-money laundering</b>	8
<b>Sanctions</b>	9
<b>Fraud</b>	10
<b>Contacts</b>	11

*"...we are about to start a thematic review of how asset managers handle the risks of money laundering and bribery. "... Perhaps this review is overdue: the asset management sector holds over £4 trillion in assets, with APCIMS members alone collectively managing assets of half a trillion pounds for six million clients. Clearly this is a huge industry, and the scope for damage should financial crime risks be mishandled is enormous."*

# Introduction

Managing financial crime risk is becoming increasingly critical for Investment Management companies such as Investment Asset Managers, Retail Fund Providers, Hedge Funds, Wealth Managers, Investment Platforms and Asset Service Providers.

It is an important focus for companies for the following reasons:

- Anti-money laundering (AML), counter terrorist financing (CTF) and financial sanctions compliance are regulatory priorities.
- HM Treasury considers money laundering a key concern and is applying pressure to the Financial Conduct Agency (the FCA) to ensure companies are doing their utmost to combat the issue.
- The UK's Bribery Act has now been in force for over two years and regulators believe that companies have had sufficient time to implement anti-bribery and corruption (ABC) systems and controls.
- The regulator is extending its scrutiny of the risks of financial crime to other areas not previously subject to focus (for example, the FCA's Thematic Reviews on asset managers).
- Criminals target those parts of the financial services industry where they perceive that controls are easier to overcome or circumvent (such as non-bank financial institutions).

Now companies' financial crime controls are in the regulatory spotlight, it is more important than ever that Investment Management companies satisfy themselves that their systems and controls are appropriate and proportionate and able to identify, monitor and manage financial crime risks. Taking the steps necessary to identify the risks; design and implement controls; monitor and improve their effectiveness, requires the right expertise and investment. KPMG can help with this.

This document contains further information on KPMG's multi-disciplinary approach to financial crime risk in Investment Management companies and outlines KPMG's service offerings in the context of a financial crime framework.



**Tom Brown**  
Partner  
Global Head of  
Investment Management



**David Hicks**  
Partner  
UK Head of Forensic



**Brian Dilley**  
Partner  
Global Head of Anti-  
Money Laundering



**John Flood**  
Partner  
Head of Investment  
Management  
Consulting UK



# KPMG’s multi-disciplinary approach

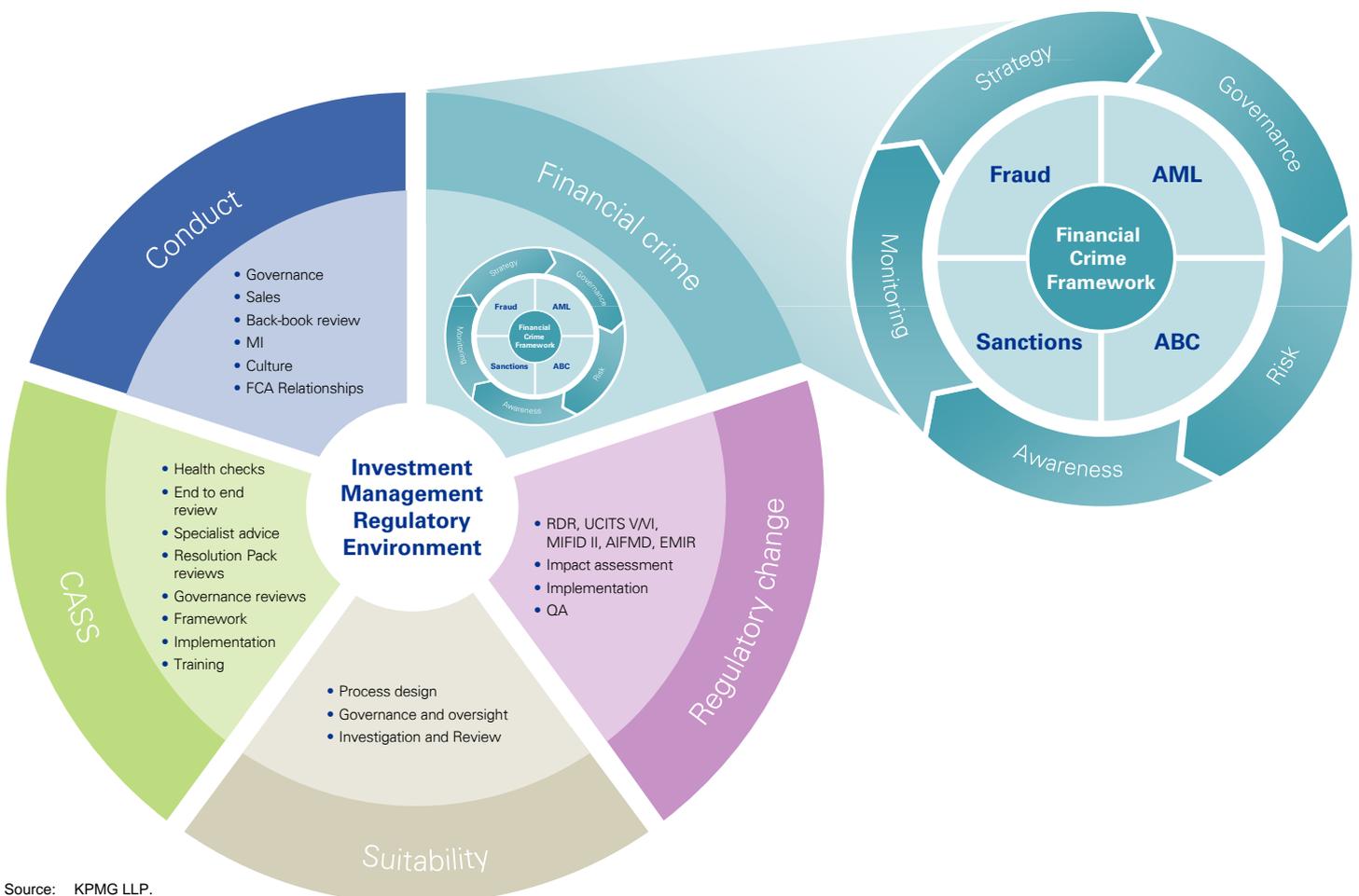
Bringing these disciplines together, member firms are able to offer a variety of services designed to assist clients with managing their financial crime and regulatory risks in the context of their business in a proportionate and cost-effective manner.

The KPMG Investment Management team has extensive experience of delivery across a wide range of Investment Management organisations, from local single fund managers to large multi-national, multi-product Investment Managers.

KPMG’s Forensic and Investment Management teams have been working together, combining their strengths in advising clients on their financial crime risks. KPMG has successfully delivered a variety of engagements, ranging from focused reviews of certain aspects of financial crime controls, to the delivery of KPMG’s extended suite of services, addressing the entire financial crime framework.

As a result of recent regulatory announcements from the FCA and the forthcoming publication of the FCA’s report arising from its Thematic Review of AML and ABC systems and controls at Asset Managers, financial crime risk management is becoming more integral to the regulatory environment in the Asset and Investment Management sector.

KPMG Forensic has a broad-ranging and multi-disciplinary approach to financial crime risks. KPMG’s financial crime framework covers AML/CTF, ABC, sanctions and fraud enabling clients to increase synergies and cross-identify risks. For example, effective sanctions compliance is underpinned by effective customer due diligence. Anti-impersonation (fraud) measures can also have AML benefits. The framework utilises robust risk assessments to inform the design of controls and the design of testing and monitoring approaches.



# KPMG service offerings

Service Group	Service Type and description	Examples
<b>Retrospective</b>	<b>Investigations</b> and <b>look-back exercises</b> to establish the facts with respect to allegations or suspicions of financial crime and/or related possible regulatory breaches.	<ul style="list-style-type: none"> <li>Sanctions 'look backs'.</li> <li>Investigations into alleged fraud, bribery or other financial crime.</li> <li>Investigations into money flows to establish occurrences of laundering.</li> </ul>
	<b>Due Diligence remediation</b> to bring records, with respect to customers and third parties, into line with policy, regulatory and legal requirements.	<ul style="list-style-type: none"> <li>Know your customer (KYC) remediation (onboarding or subsequent).</li> <li>Source of Wealth and Source of Funds memoranda.</li> </ul>
<b>Current state</b>	<b>Risk assessments</b> (including identification of key risk indicators) to provide clients with a sufficient understanding of financial crime risk exposure.	<ul style="list-style-type: none"> <li>Inherent Business Risk Assessments for AML/CTF, ABC, Sanctions and Fraud to identify where mitigation is required.</li> </ul>
	<b>Gap analysis</b> (against regulatory expectations and/or client policies) to identify potential weaknesses and recommend improvements.	<ul style="list-style-type: none"> <li>AML/CTF, ABC and Sanctions gap analyses against specific legal/regulatory obligations.</li> <li>Fraud, bribery and corruption gap analysis against our view of industry practice.</li> </ul>
	<b>Controls testing</b> to establish effectiveness.	<ul style="list-style-type: none"> <li>Due diligence file reviews.</li> <li>Automated testing of screening tools and filters (e.g. Politically Exposed Persons (PEP) screening, payment filters).</li> </ul>
	<b>Vendor/supplier assessments</b> to enable outsourcing decision making and ongoing oversight.	<ul style="list-style-type: none"> <li>Review of third party controls against client requirements.</li> <li>Review of management information (MI) provided by third parties.</li> </ul>
<b>Change</b>	<b>Policy development</b> to align financial crime policies with legal and regulatory requirements and/or Group policies.	<ul style="list-style-type: none"> <li>Refinement of existing, challenge of proposed changes or development of new ABC, AML/CTF, Sanctions and Fraud policies.</li> </ul>
	Designing and implementing <b>operating models</b> to enable policy compliance.	<ul style="list-style-type: none"> <li>Designing and implementing operating models to enable end-to-end management of Introducer relationships.</li> <li>Building models for managing, recording and reviewing gifts and entertainment, in addition to charitable and political donations.</li> </ul>
	<b>E-learning</b> or tailored face to face <b>training</b> to inform and train client personnel.	<ul style="list-style-type: none"> <li>AML/CTF and Sanctions staff and executive training packages.</li> <li>Awareness training (ABC and fraud).</li> </ul>
	<b>Change management</b> to reduce the impact of policy and/or procedural changes on day-to-day business.	<ul style="list-style-type: none"> <li>AML/CTF Operational Transformation Programmes to manage the implementation of revised operating models and procedures.</li> </ul>
<b>Forward looking</b>	<b>Impact assessments</b> to help clients understand how future changes to financial crime related laws and regulations are likely to affect their business.	<ul style="list-style-type: none"> <li>Analysis of potential impact of proposed Fourth EU Money Laundering Directive to develop compliance options.</li> </ul>

## Intended client benefits

- Comfort for senior management that financial crime risks have been identified and are being managed through fit for purpose controls.
- Industry insight regarding current practice of peers and other sectors.
- Effective and independent review of existing controls to identify weaknesses or areas for improvement.
- Guidance through the development and maintenance of effective financial crime compliance and risk management programmes.
- Tailored approach calibrated to align with individual risk appetite.
- Support for responding to allegations and preparing for regulatory inspections (e.g. FCA visits, Thematic Reviews, requests for Board attestations, 'skilled person' reports and Enforcement investigations) from subject matter specialists.
- Enabling well informed management decision making (e.g. cost management versus risk management).

# KPMG UK's team

- Our specialists have an in-depth knowledge of the legal and regulatory requirements regarding the various forms of financial crime that may impact upon organisations. We can work with clients proactively to help achieve compliance, or reactively to help respond to regulatory or law enforcement action in these areas.
- KPMG's multi-disciplined teams include accountants, lawyers, ex-regulators, ex-police investigators but also people with different financial and non-financial industry backgrounds.
- KPMG UK has extensive experience in assisting Investment Management clients with a range of regulatory issues and challenges.
- KPMG member firms have a global network of anti-bribery and corruption experts and are focused on providing broad-ranging and integrated global solutions.
- We have a large global network of AML subject matter experts.

- We work closely with Forensic technology specialists who support our work.
- Our Fraud Risk Management specialists are experienced in investigating small to large-scale frauds and misconduct and can use this experience to challenge established controls.

## KPMG's strength

- KPMG's client work enables significant insight into Investment Management companies' practical application of the risk based approach to financial crime controls.
- KPMG has developed a target operating model to manage the life-cycle of third party Introducer relationships.
- KPMG member firms have a global AML methodology and training programme designed to achieve cross-border consistency.
- KPMG UK has worked with some of the biggest names in both the

financial and corporate spheres ensuring AML compliance.

- KPMG UK's experience includes testing of sanctions and PEP screening systems, as well as having performed some of the largest sanctions look-back and KYC remediation projects.
- KPMG UK's experience of working with clients across the financial services industry provides us with detailed insights of the issues they face and how they configure their sanctions screening systems. This enables us to benchmark findings of our testing against peers.
- KPMG member firms have an established global fraud risk management methodology.



# Anti-bribery and corruption (ABC)

**How does your organisation ensure that it identifies and manages all 'introducer' relationships?**

**Is appropriate risk assessment and due diligence performed with respect to your third parties?**

**Does your Board receive the right Management Information (MI) on ABC risks to enable informed decision making?**

**Have you performed and regularly updated a tailored risk assessment to identify ABC risks/issues and focus resources accordingly?**

**How do you satisfy yourself that your company has 'adequate procedures' to manage the risks of bribery and corruption?**

## ABC Compliance requirements

Investment Management companies operating in the UK are subject to the requirements of the UK Bribery Act (which took effect on 1 July 2011) and the FCA's high-level Systems and Controls rules on financial crime. Broadly, Investment Management companies should be taking account of the Ministry of Justice's guidance and ensure that they have 'adequate procedures' in place to combat the risks of bribery and corruption.

## ABC risks and challenges in Investment Management

Below are examples of some of the bribery and corruption risks we have observed through our work in the Investment Management sector:

- Inappropriate payments by agents/intermediaries to win client business.
- Bribery of key intermediaries, such as investment consultants or trustees, to recommend funds.
- Payments to suppliers, creating connections to PEPs.
- Facilitation payments to obtain licences when investing in overseas jurisdictions.
- Investment in corrupt businesses or bribes offered to Portfolio Managers in return for investment or for confidential information.
- Traders offering preferential treatment to brokers in return for kickbacks.

## Service offerings

- Performing and/or challenging company-wide ABC risk assessments.
- Designing and implementing operating models to enable management of Introducer relationships.
- Designing and implementing frameworks for due diligence, approvals, and relationship monitoring of third parties (including suppliers).
- Providing a tuneable risk calculator to assess third party relationships.
- Building models for managing, recording and reviewing gifts and entertainment, as well as charitable and political donations.
- Providing scripts and training modules for ABC awareness training and communications strategies for rolling out the programme and training.
- Investigations into allegations of bribery.

*"...foreign bribery undermines civil society, and ultimately harms the poorest most. We can never accept the argument that a bribe is just the necessary price for doing business abroad."*

# Anti-money laundering (AML) and Counter Terrorist Financing (CTF)

**How does your company manage varying AML/CTF legal and regulatory requirements across the jurisdictions in which it operates?**

**What is the extent of your company's exposure to PEPs and high risk jurisdictions?**

**Which AML/CTF risks are currently being managed outside of the company's risk appetite?**

**What steps are taken to ensure that systems and technology relied upon are appropriate for the business and calibrated in accordance with the company's risk appetite?**

**How do senior management provide active leadership and management of money laundering and terrorist financing risks?**

## **AML/CTF compliance requirements**

Investment Management companies operating in the UK are subject to key legislation and rules including the UK Money Laundering Regulations 2007, the Proceeds of Crime Act 2002, the Counter Terrorism Act 2008 and the FCA's Handbook of Rules.

Tackling money laundering and terrorist financing continues to be a regulatory and political priority, in the UK and beyond. This is demonstrated by the penalties imposed and financial settlements agreed on, and by extension, the proposed updates to legislative frameworks.

The regulatory field of view is expanding to encompass additional areas of perceived money laundering and/or terrorist financing risk within the financial services sector. Consequently, it has never been more important for Investment Managers to be satisfied that they are taking appropriate and proportionate measures to identify, assess, monitor and manage money laundering and terrorist financing risks.

## **AML/CTF risks and challenges in Investment Management:**

- Criminals target where they perceive the 'barriers to entry' to be lowest – AML/CTF controls have strengthened in other sectors.
- Different client types, delivery channels and product features (e.g. institutional versus retail, intermediated versus direct distribution and third party payment facilities) can present different money laundering and/or terrorist financing risks.
- Potential exposure to higher risk situations:
  - Clients with more complex and/or opaque ownership and control structures (e.g. offshore trusts, companies and investment vehicles, privately owned companies).
  - Exposure to higher risk jurisdictions through cross-border services.
- Reliance on third parties (e.g. distributors, platforms and intermediaries) in multiple jurisdictions can expose companies to variable standards (e.g. KYC).
- Access to and quality of customer data can inhibit the ability to identify and manage AML/CTF risks.
- Business growth (particularly acquisitive growth) can lead to inconsistent application of policies and procedures.

## **How KPMG can help**

- Ongoing monitoring of financial crime risk exposure and ongoing assurance as to the effectiveness of an institution's risk management framework is critical. KPMG UK has extensive experience of assisting companies, with a range of proactive and reactive services designed to support and improve AML/CTF compliance and risk management programmes.

## **Service offerings**

- Reviews and gap analysis of existing AML/CTF systems, controls, policies and procedures (against both regulatory expectations and a company's own AML/CTF policies).
- AML/CTF policy development.
- AML/CTF risk assessments (including third party vendor/supplier assessments).
- Control testing (through manual reviews, data analysis and automated testing).
- Operational Transformation Programmes.
- Client file remediation (including due diligence, source of wealth and source of funds).
- Investigations.
- Regulatory change impact assessments.

# Sanctions

**How do you align your sanctions compliance programme to relevant risks?**

**What oversight and governance does senior management exercise over your company's sanctions programme?**

**How does your company meet its financial sanctions obligations across the different jurisdictions in which it operates?**

**How do you obtain comfort as to the operation of any 'black box' tools within your sanctions programme?**

**Is the appropriate level of due diligence performed for high risk investments to identify potential sanctions concerns?**

**What information is escalated regarding sanctions risk to enable timely management?**

## Sanctions compliance requirements

Investment Management companies are required to comply with the UK financial and economic sanctions regimes for certain entities, types of trade, goods and activities to achieve certain public policy objectives (including the prevention of weapons of mass destruction proliferation).

The UK Treasury maintains a consolidated list of financial sanctions targets designated by the United Nations, the European Union and the United Kingdom. In general terms, the law requires companies not to provide funds or, in the case of the Terrorism Order, financial services, to those on the list, unless a licence is obtained from the UK Treasury's Financial Sanctions function.

Recent UK and US enforcement actions in this area have emphasised the importance of ensuring that companies understand and comply with their sanctions obligations.

## Sanctions risks and challenges in Investment Management:

- Data issues (completeness and quality) can inhibit identification of sanctioned entities.
- Poorly integrated client systems.
- Some investment managers run numerous sanctions screening solutions which may be differently configured and which produce inconsistent results.
- Reliance on third parties that don't necessarily apply similar standards in their sanctions screening processes.
- Visibility of the underlying client can vary depending on the product in question which could increase sanctions risks.
- Investment due diligence tends to rely on the listed status of vehicles being invested in rather than actual consideration of sanctions risks.

## Service offerings

- Reviews and gap analysis of existing sanctions policies and procedures, processes and controls.
- Sanctions policy development.
- Sanctions risk assessment.
- Sanctions control testing (including testing of automated screens and filters).
- Sanctions 'look back' exercises.
- Sanctions screening vendor selection advice.
- System tuning advice.
- Design and delivery of sanctions training.

*"Weaknesses and issues we found repeatedly among the major financial groups and medium-sized firms surveyed included "... the failure to monitor the ongoing effectiveness of automated systems used for financial sanctions screening, including making sure that the calibration of screening rules remained appropriate and effective."*

# Fraud

**Who owns fraud risk in your organisation?**

**Where do the key fraud risks lie in your business? Are anti-fraud controls aligned to these risks?**

**How do your fraud and misconduct risks differ across business units, geographies and processes?**

**How do you test the operating effectiveness of your anti-fraud controls?**

**Are senior management receiving adequate management information that may indicate early warning signs of fraud?**

## Fraud compliance requirements

A reputation for integrity is critical to safeguarding market confidence and public trust in Investment Management companies. Unfortunately, fraud and misconduct can seriously undermine reputation. KPMG's latest fraud barometer report published on the 2 July 2013 shows that the value of fraud in the UK has increased by 38% to £0.5 billion in the first half of 2013 compared to the same period in 2012. In particular, investor fraud almost quadrupled from £19 million to £74 million.

Financial crime (as defined by the Financial Services and Markets Act 2000) includes fraud or dishonesty. The FCA's rules and guidance regarding financial crime therefore apply equally to fraud risk. Occurrences of fraud with an external impact inevitably lead to questions regarding the robustness of risk management controls. Fraud with an internal impact is of particular concern to shareholders and owners who ultimately suffer the arising loss. Regulators are becoming increasingly interested in steps taken by organisations to protect themselves and their customers against fraud. In those organisations where fraud has been uncovered, there has been greater regulatory scrutiny of their management of fraud risks and controls.

## Fraud risks and challenges in Investment Management:

- Insider trading to enhance performance on a portfolio or for personal gain through personal account dealing.
- Unauthorised trading to enhance performance on a fund or to hide losses.
- Diversion of client funds through manipulation of client instructions.
- Manipulation of retrocession payment calculations.
- Investments in Ponzi schemes.
- Manipulating the valuation of complex or illiquid assets to enhance the performance of funds.

## How KPMG can help

Failing to manage the risk of fraud effectively leaves organisations vulnerable to material losses which may have been avoided. Our Fraud Risk Management services are aimed at helping clients achieve three objectives:

- Prevent instances of potential fraud and misconduct occurring in the first place.
- Detect potential instances quickly when they do occur.
- Respond appropriately and take corrective action when potential instances arise.

## Service offerings

- Benchmarking fraud risk management arrangements against our view of leading practice and regulatory guidance using our five pillar approach.
- Policy development (anti-fraud policy, fraud response plans).
- Fraud risk assessments and identification of key risk indicators.
- Testing of key fraud risk controls.
- Fraud awareness training (e-learning, face to face training).
- Fraud investigations.

## Contact us

### David Hicks

UK Head of Forensic

**T.** +44 (0) 20 7694 2916

**E.** david.hicks@kpmg.co.uk

### Brian Dilley

Global Head of Anti-Money Laundering

**T.** +44 (0) 20 7896 4843

**E.** brian.dilley@kpmg.co.uk

### Tom Brown

Global Head of Investment Management

**T.** +44 (0) 20 7694 2011

**E.** tom.brown@kpmg.co.uk

### John Flood

Head of Investment Management Consulting UK

**T.** +44 (0) 20 7311 6870

**E.** john.flood@kpmg.co.uk

[www.kpmg.co.uk](http://www.kpmg.co.uk)

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2013 KPMG LLP, a UK limited liability partnership, is a subsidiary of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative, a Swiss entity. All rights reserved.

The KPMG name, logo and “cutting through complexity” are registered trademarks or trademarks of KPMG International.