Global Anti-Money Laundering Survey 2007
How banks are facing up to the challenge
Foreword

Estimated money laundering flows are reported to be in excess of US$1 trillion being laundered every year by drug dealers, arms traffickers and other criminals\(^1\). Recent years have seen rapid change in the financial services industry and growing regulatory expectations and pressures. Combating money laundering and terrorist financing continues to be a major challenge for the banking sector, as gatekeepers to the legitimate financial system.

Given this backdrop, KPMG International commissioned this Global Anti-Money Laundering (AML) Survey to build on the findings from our last survey in 2004. Three years on, we have sought to establish whether the significant changes in the financial and regulatory environment have led to increased focus on AML and new and improved ways of tackling the challenge. Our survey shows how significantly banks have responded to this challenge – in increased investment, senior management focus, and cooperation with governments, regulators and law enforcement. Despite this good intent and strong commitment, many banks continue to struggle to design and implement an effective AML strategy, and they believe that much more needs to be done internationally to combat money laundering more effectively.

Since our last survey in 2004, there has been unprecedented change in the financial market place and the regulatory environment, key developments include:

- Banks have a more international footprint, markets and products have become more complex, there is greater investment in emerging markets, the amount of privately held wealth has vastly increased, and all alternative asset classes have undergone significant growth. These structural changes have deep implications for how banks tackle the challenges of AML and counter-terrorist financing (CTF).
- At the same time, banks have had to come to terms with significant regulatory change across all of their activities and operations globally. This includes legislative changes (for example, those stemming from Basel III) but also increased focus on the wider responsibilities of financial institutions, and development of the right regulatory framework to deliver the outcomes governments and regulators seek. This has led to stronger emphasis on corporate governance and senior management accountability, and has led some governments, in particular the U.S. government, to seek to apply their standards globally through the extra-territorial reach of U.S. law.
- In addition to the wider regulatory changes, there have been enhancements in AML standards specifically, with changes in the requirements of the Financial Action Task Force (FATF) and Wolfsberg Group, together with new legislation at the national and supranational level (including the EU Third Money Laundering Directive). There has also been tougher enforcement of AML requirements, particularly in the U.S. but also internationally, reinforcing the message that money laundering remains a key priority for banks.

Our survey points towards significant investment and improvement in the AML systems and controls environment within individual financial institutions, together with an understanding and commitment to the role banks have to play in the overall AML and counter-terrorism effort. However, there is also more to be done to make the financial system less vulnerable to money laundering and terrorist financing. For banks, this means greater focus on the
effectiveness of their AML and CTF strategy, systems and controls. For the government, regulatory and law enforcement community, it means greater partnership with banks, including clearer and better information sharing. There are already signs of progress, with banks and the public sector moving in the right direction, but it will be important for this momentum to be maintained.

Set against this background, we are pleased to publish KPMG Forensic’s second Global AML Survey. Reflecting the themes that have driven financial markets in the past three years, our survey this year has looked in greater depth at emerging markets, with more participants in the survey coming from these countries and more analysis of the underlying results. We have also added sections on each region to explain how the survey results relate more directly to them.

All of this should help our firms’ clients and regulators to benchmark banks’ AML systems and controls against trends, peer comparisons and opportunities in a more precise way. Likewise for law enforcement and policymakers, the survey aims to provide an insight into how the industry is embedding new requirements and provides some thoughts for future AML policy direction.

Our first Global AML Survey in 2004 was extremely well received by the industry, and helped to provoke discussion and debate among banks, practitioners, regulators, governments and law enforcement alike. We believe that this survey is one of the most detailed and authoritative reports on AML systems and controls undertaken in the market place, and we hope that you will take this opportunity to consider how to respond to the challenges in today’s financial services industry.

We would like to thank all the 224 banks and senior executives that participated in the survey.

Brendan Nelson
Global Chairman
KPMG Financial Services

Karen Briggs
Global Head of AML
KPMG Forensic
224 respondents overall, up from 209 in 2004

Over 25% of the top 250 banks represented

55 countries covered

60% of the banks surveyed were multi-national
Executive Summary

KPMG’s Global AML Survey 2007 explores the range of challenges that banking institutions face in complying with global AML requirements. We have used the same methodology as the 2004 survey, to ensure comparability of results over the intervening three years.

The survey covered the following topics:
1. The role of senior management in AML issues
2. The costs of AML compliance
3. AML policies and procedures
4. Formal monitoring of AML systems and controls
5. Taking a risk-based approach to ‘Know Your Customer’ activity
6. Politically Exposed Persons
7. Transaction monitoring
8. Training
9. Attitudes towards regulation
10. Sanctions compliance

Strong senior management engagement in AML efforts

Banks in our survey reported that senior management were more engaged in AML issues than they had been in 2004, with the percentage of respondents reporting that their senior management and their board of directors take an active interest in AML increasing by 10 percentage points to 71%. The result reflects a mix of regulatory and international pressure on senior management to take responsibility for the full range of risks in their business, including compliance, as well as continued focus on counter-terrorist financing. As the financial services industry becomes more complex, and AML risks become more pressing, it will be important that this heightened interest in AML is directed towards ensuring systems and controls are effective in practice.

AML costs have grown well beyond expectations

Average AML costs were reported by the participants in our survey to have increased by 58% over the last three years. This was more than banks had expected when we carried out our 2004 survey - at that time, banks predicted costs would only rise by 43% over the following three years. Despite the unexpectedly high increase in AML costs, respondents anticipate that growth will slow, with banks predicting an average increase of 34% in AML costs over the next three years.

The main drivers of the past and future increases in costs continue to be transaction monitoring and staff training, consistent with the 2004 survey. As banks develop more risk-based AML programs, the pressure will be to focus on using resources within compliance effectively and efficiently, and this may involve considerable reallocation of resources within compliance as well as cost reduction through outsourcing, offshoring or centralization of AML functions.

Setting a global standard

With growth in the proportion of income derived from international business, banks have become more global in their approach to managing AML risk. Nearly 85% of internationally active banks...
reported that they had a global AML policy in place. As ever, though, the challenge is to ensure effective implementation of policies at the local level.

More monitoring and testing of AML systems and controls
Greater regulatory focus on governance, and the resulting increase in the accountability of senior management for AML, appears to have driven up the amount of independent monitoring and testing of AML systems and controls. More banks report that they have a monitoring and testing program in place, and banks report that a wider range of functions within their organization are involved in this. The key to successful testing and monitoring, however, relies on a strong drive from senior management as well as effective and timely follow-up and feedback of improvements into current systems and controls.

Broader acceptance of a risk-based approach
Our survey shows an increase in the number of banks using a risk-based approach to determine the level of due diligence performed on clients at account-opening stage (‘Know Your Customer’ or KYC processes). In addition, a wider range of risk factors are taken into account than was the case in our 2004 survey, recognizing the evolving international best practice in this area and greater focus on reputational risk among banks. Going forward, banks in many regions are likely to be under pressure to extend a risk-based approach to other areas of their AML strategy and – where they are given more flexibility in the design of AML processes – they will be under pressure to document the rationale for their approach so that they have an audit trail for the decisions they have made.

More focus on Politically Exposed Persons (PEPs)
Increased regulatory and industry focus has led more banks to seek to apply additional scrutiny to PEPs. In our 2004 survey, a surprisingly low number of banks performed enhanced due diligence on PEPs at account-opening (65%); this year, the figure has increased to 81%. Moreover, significant numbers of banks have put in place specific procedures to identify and monitor PEPs on an ongoing basis (71% of all banks in our survey). However, with no universal definition of a PEP, there are likely to be substantial differences between individual banks’ interpretation of the requirements in practice. With greater sensitivity to the reputational consequences of dealing with PEPs, banks are likely to be under pressure to examine how robust their procedures for PEPs really are. This is even more relevant in markets where business and politics are closely intertwined.

Continued strong investment in transaction monitoring
Virtually all respondents rely heavily on their people to spot suspicious activity, and with banking becoming more electronically based, many are investing in sophisticated IT monitoring systems. Transaction monitoring continues to be the single greatest area of AML expenditure for banks, and is expected to remain so over the next three years. Despite this, many banks want to improve the quality of their transaction monitoring, with many looking to invest in enhancing system capacity, functionality and coverage. Banks need to understand, however, that IT systems are only one component of an effective AML strategy and that they are no substitute for well-trained and vigilant staff.

Vigilant staff are the first line of defense but focus is now on effectiveness of training
The proportion of banks training over 60% of their staff has grown by 9 percentage points since 2004, with face-to-face training, the most commonly used mechanism and the method regarded as the single most effective. Banks continue to report that properly trained staff is the best AML control, and this is reflected in continued high spending on training programs.

The regulatory focus now is moving to the effectiveness of all this training, with pressure to implement more tailored training and testing, and evidence that staff have the level of AML understanding they need to carry out their role.

Broad-based support for regulatory AML efforts, but more needs to be done
The survey shows continued support for global AML efforts by regulators, governments and law enforcement, with 93% of banks saying the burden of regulation is either acceptable or should be increased. However, a 51% majority of banks still believe that AML regulation could be focused more effectively, through clearer legislation, better feedback to the industry and a greater endorsement of a risk-based approach. While some banks have called for wider acceptance of a risk-based approach to AML, there is concern over whether regulators are willing to accept all of the consequences that flow from this. Even so, banks, governments, regulators and law enforcement agencies are united in seeking more collaboration and information-sharing although banks are uncertain as to how such a public-private partnership will really work in practice.
Sanctions compliance a key challenge for banks

Sanctions compliance was a major driver of AML costs over the past three years, being ranked the third greatest area of AML expenditure after transaction monitoring and staff training. This reflects increased focus on counter-terrorism, the long arm of the U.S. law, and growth in the number of lists that banks need to monitor against, as well as the tougher enforcement of sanctions requirements by regulators. Despite the progress made so far, there is more to do in this area, as banks work to ensure they design operational processes that are equal to the task of complying with sanctions rules that are detailed, complex and potentially broad in scope. A particular challenge is the design and implementation of a sanctions compliance program that can support this goal.

Looking ahead

The survey results show significant investment in AML systems and controls, and increased engagement from senior management. The challenge for many banks will be to maintain this focus as they enter a new phase of regulatory initiatives (Basel II, EU regulatory change and the extra-territorial effects of U.S. legislation being some of the more high-profile examples). Banks may also find it challenging to adapt to many of the key changes that are taking place in the financial services market, with increased product complexity, greater involvement with emerging markets, and integration of mergers that have taken place on a new scale. All of these mean future challenges in relation to AML compliance going forward.

Overall, although much has been achieved, there is still much to do to make the financial system more robust in the fight against money laundering.
Compliance starts at the top. It will be most effective in a corporate culture that emphasises standards of honesty and integrity and in which the board of directors and senior management lead by example. It concerns everyone within the bank and should be viewed as an integral part of the bank’s business activities. A bank should hold itself to high standards when carrying on business, and at all times strive to observe the spirit as well as the letter of the law.