Reporting culture within investment firms

The reporting of unusual transactions (Wwft)

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The Dutch Authority for the Financial Markets (AFM)

The AFM is committed to promoting fair and transparent financial markets.

As an independent market conduct authority, we contribute to a sustainable financial system and prosperity in the Netherlands.

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1. Introduction

In recent years, due to increasing terrorism threat and money laundering at banks, the societal interest in money laundering and terrorist financing has increased[1]. The Dutch Authority for the Financial Markets (AFM) monitors compliance with the Money Laundering and Terrorist Financing (Prevention) Act (Wwft) and the Sanctions Act (Sanctiewet) among investment firms[2]. In 2018, a questionnaire was distributed among 289 investment firms[3]. This questionnaire (after this: Questionnaire Wwft and Sw) focused on the presence of inherent risks and control measures with regard to the Wwft[4]. In order to gain more insight into the way in which investment firms deal with the Wwft and specifically the reporting of unusual transactions, an in-depth investigation was carried out among 17 investment firms. Another aim is to increase the understanding and awareness of unusual transactions among investment firms. By means of a survey and interviews among employees and compliance officers (see appendix: Research method), the AFM has identified the reporting culture among these companies and impeding and stimulating factors that play a role in reporting conduct. *The reporting culture is the extent to which it is considered important and encouraged to report unusual transactions.* The AFM conducts research into the organizational culture of financial companies, because the culture highly determines employee behavior and, in turn, the functioning of the company.

In Chapter 2 the general findings are outlined, in Chapter 3 the conclusions and recommendations can be found and more information about the research method is included in the Appendix.

Findings

The presence of clear policy with regard to reporting unusual transactions contributes to a strong reporting culture. A strong reporting culture on its turn contributes to higher reporting conduct, a better reputation and higher customer satisfaction. To avoiding reputation damage, investment firms experience the urgency to report unusual transactions. At the same time, the awareness of the Wwft can decrease when no incidents occur. It is also not always clear what is meant by an unusual transaction and filing a report is often seen as time-consuming. The AFM encourages investment firms to keep a sense of urgency regarding the Wwft, for example by providing training to employees on a regular basis and to pay more attention to the scope of unusual transactions in policy and procedures. In order to get a broader understanding of unusual transactions, the AFM has drawn up a handout for employees with an overview of moments that might have to be reported.

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[1] Among others ING, Rabobank and Danske Bank.
[2] In Dutch: www.afm.nl/professionals/onderwerpen/wwft-wet.
[3] In Dutch: www.afm.nl/professionals/nieuws/2018/dec/beleggingsondernemingen-wwft-onderzoek.
[4] Questionnaire Wwft and SW: aimed at clients based in high-risk countries, asset-management, special purpose vehicles, training on Wwft and Sanctions Act, and existing policy regarding Wwft.

2. General findings

Investment firms have and apply policy with regard to prevention of money laundering and terrorist financing. In the survey, employees of almost all investment firms indicated that there is a policy with regard to reporting unusual transactions. In general, it is clear to them how they can file a report. This contributes to a strong reporting culture – where the reporting of unusual transactions is considered important and encouraged – and to higher reporting conduct (i.e. the actual reporting of unusual transactions), as appears from the correlations from the survey. This is in line with the Questionnaire Wwft and Sw, which shows that 16 of 17 investment firms have specific policy for reporting unusual transactions and have adjusted this policy in the past two years. During the interviews, employees indicated that the AFM guidelines are helpful in drafting policy with regard to the Wwft, in particular for client research[5]. According to them, investment firms pay attention to mapping the origin of the assets and the Ultimate Beneficial Owner (UBO), for which formats and audit questions are available[6]. For the internal reporting of an unusual transaction, there is often not a structured process. Interviewees note that the first step is often contacting Compliance. It should be, however, noted that the majority of the interviewees have never filed a report so far.

Investment firms experience the urgency to report unusual transactions. Although it seems that unusual transactions remain often unreported, employees in the survey indicate that if an unusual transaction takes place this would be reported[7]. In the interviews, employees emphasize the importance of reporting unusual transactions to avoid reputational damage. Clients trust that their assets are in good hands so investment firms cannot afford a scandal. According to interviewees, the flat hierarchy and small size of these investment firms ensure that employees quickly find each other and share (customer) information with each other. This ensures that when there are noticeable issues, for example deviating transactions or client requests, they are quickly discussed with each other. In case of doubt, Compliance and the management are contacted. The investment firms that filed a report to the Financial Intelligence Unit (FIU) followed this same procedure.

"The lines of communication are short. When I have just a little doubt about something, it is directly discussed in the dealing room and with management."

Client knowledge contributes to the firm's reputation and customer satisfaction. The survey shows that the investment firms focus on identifying the identity of their client and the origin of the assets. In firms where employees are positive about their client knowledge, employees value the firm's reputation better and also the extent to which they think clients are satisfied with the service. According to the correlations from the survey, more client knowledge contributes to a better reputation and higher customer satisfaction. The interviews show that the extent to which

[5] KYC/CDD-policy.
[6] In this investigation, the AFM did not look at the content of policy only into the existence.
[7] Despite an upward trend, investment firms still report few unusual transactions to FIU-Netherlands.

attention is paid to obtaining information about clients within investment firms has increased in recent years. Investors understand that they have to provide more information. As an investment firm, it helps to explain to clients about the importance of providing this information. One investment firm sees this as a commercial advantage, namely more knowledge of (the origin of) the assets provides more focused advice and broader services[8]. Investment firms that have a lot of knowledge about clients also show less undesirable work behavior, such as cutting corners by employees and management and being absent without good reason. In addition to client knowledge, a strong reporting culture also correlates with a better reputation and higher customer satisfaction.

It is often unclear what is meant by "unusual transaction". Although a great deal of effort is being made to trace the origin of the assets and the UBO, employees in the survey are less positive about the extent to which they have sufficient overview on unusual transactions. The interviews show that the scope of an unusual transaction is often unclear. Employees often only think about it in terms of deviating transactions. Employees were usually unaware that the cases where they did not accept a client because, for instance, the client did not reveal the origin of assets, can also be worthy to report. The internal policy offers insufficient clarity in this. Uncertainty about what is meant by an unusual transaction causes a variety of interpretations among employees about whether something is unusual or not. The interviews also show that employees mainly rely on their own professional judgment. Education or training can ensure that the same standard is used for this judgment. The Questionnaire Wwft and Sw shows that 30% of the 17 investment firms do not have any training specifically for the Wwft. The interviews show that the level of education regarding the Wwft varies from following internal modules and repeated training for all employees to having a DSI registration in which attention is paid to the Wwft. However, sometimes there is only training for managers or a one-off training for new employees. In the interviews, employees see room for improvement in order to obtain persistent knowledge regarding money laundering and unusual transactions.

"I estimate an unusual transaction myself with the knowledge and experience that I have. I think others do the same, but we don't really talk about it openly."

It takes a lot of time to report an unusual transaction. Of all the topics surveyed in the survey, employees are least positive about the extent to which it is made easy to report an unusual transaction internally. Filing a report takes a lot of time, where interviewees see room for improvement. According to the correlations from the survey, the ease to file a report is strongly related to whether employees are willing to report an unusual transaction when it occurs.

The awareness of the Wwft decreases when no incidents occur. In the interviews, employees indicated that acquired knowledge regarding the Wwft during training sessions diminished after a period of time and that, when no incidents occur, attention for the Wwft declines. The risk is that

[8] Adjusting investment advice (customization) and insight into possible additional assets that are not yet managed.

this becomes a downward spiral. Without confirmation of necessity, the sense of urgency disappears and employees become less alert and file fewer reports. In the mere case of a report by an investment firm at the FIU, there was no feedback to the reporter, which makes it difficult for the reporter to determine whether a suspicion is well-founded. Interviewees saw room for improvement in creating sustained attention for money laundering and terrorist financing. Providing regular training to employees and the tone at the top play an important role in maintaining that sense of urgency. More specifically, the survey shows room for improvement in terms of communicating the importance of reporting unusual transactions by the management and actively encouraging employees to report unusual transactions. This in turn contributes to a strong reporting culture, as appears from the correlations from the survey.

"It is always a bit paradoxical; at the moment that an incident really occurs, everyone is back on their toes."

Although interviewees indicated that the number of high-risk clients and complex client constructions is low, the Questionnaire Wwft and Sw shows that 82% of the 17 investment firms serve clients from high-risk countries. In some cases this is more than 20% of the total client file. Continued attention for unusual transactions is therefore important, as customers from a high risk country carry certain risks.

Investment firms report primarily from their own interest and not their social responsibility.
The interviews show that investment firms are mainly focused on preventing involvement in money laundering scandals or terrorist financing. If a client does not want to provide information or if there is a suspicion of an unusual transaction, no service is offered. However, often no report is filed in these situations, while an intended transaction must also be reported. At the same time, almost all interviewees value trust in the financial sector. The money laundering scandals at major banks have caused reputational damage that also affects investment firms. The feeling that reporting unusual transactions not only serves the company but also benefits the sector was, however, not explicitly mentioned during the interviews. According to the correlations from the survey, companies with more focus on their social responsibility have a stronger reporting culture and are more positive about the firm's reputation and customer satisfaction. In other words, reporting unusual transactions from a societal interest has positive consequences for the firm itself.

3. Conclusion and recommendations

All 17 investment firms have apply policy with regard to prevention of money laundering and terrorism financing, which contributes to a strong reporting culture. Despite only a few unusual transactions have been reported so far, employees seem motivated to report when one occurs. The reputational damage that can arise from a scandal is a great incentive for them to pay attention to the Money Laundering and Terrorist Financing (Prevention) Act (Wwft).

Understanding of the term "unusual transaction" is limited

It was often unclear for investment firms what is meant by "unusual transaction". It is often solely interpreted as a deviating transaction pattern, but its scope is broader[9]. Investment firms can pay more attention to this in policy and procedures by providing more concrete examples of unusual transactions.

It takes a lot of time to report an unusual transaction

Reporting an unusual transaction within the organisation is mainly seen as time-consuming. Investigating the process of reporting errors can be a good next step for investment firms in order to make improvements. The ease to report unusual transactions and sufficient client knowledge contributes to the reporting conduct of employees and the firms' reputation and client satisfaction.

It is essential to keep a sense of urgency regarding the Wwft

Investment firms need to create sustained attention for money laundering and terrorism financing. The awareness must not diminish when the societal attention decreases. Here, the tone at the top and providing training to employees regularly play an important role. When creating awareness for reporting unusual transactions, it is desirable to not only emphasize the firm's interest but also the societal interest of preventing money laundering and terrorism financing. Acknowledging one's social responsibility contributes to a strong reporting culture.

To keep a sense of urgency regarding the Wwft and get a broader understanding of unusual transactions, the AFM has drawn up a handout with an overview of moments that might have to be reported ("Reporting unusual transactions: when do I need to be alert?"). This Handout can help employees identify unusual transactions.

[9] One can consult the AFM website for guidelines, examples of unusual transactions and frequently asked questions (in Dutch): www.afm.nl/professionals/onderwerpen/wwft-wet.

Appendix: Research method

An anonymous survey was distributed among employees of 17 investment firms. These companies were selected on the basis of two criteria, namely > 20 clients, and > 10 FTE customer contact, based on the Questionnaire Wwft and Sanctions Act of 2018. The survey has been broadly distributed among employees who deal with the Wwft (selected by the firm itself). A total of 279 questionnaires were completed (response rate = 94%). The survey concerned how employees deal with unusual transaction in practice. Below the constructs (i.e. combination of questions that jointly capture a specific topic) can be found that were measured in the survey on a 7-point scale from 1 = strongly disagree to 7 = strongly agree (4 = neutral). These constructs are measured reliable (α > .70) in the current research. Correlational analyses were performed to test relationships between these constructs, for instance, whether reporting culture is linked to stronger reporting conduct. This does not point to a causal relationship (i.e. one *leads* to the other), rather a plausible relationship. Because the research is based on self-report measures, the findings refer to perceptions of employees regarding the reporting of unusual transactions and not to whether firms actually report all unusual transactions.

Constructs

- Policy: 5 questions, e.g. "I know which procedures to follow in case of an unusual transaction" (α = .90)
- Top: 4 questions, e.g. "The board propagates the importance of reporting unusual transactions" (α = .74)
- Leadership: 4 questions, e.g. "My manager offers support when reporting unusual transactions" (α = .83)
- Execution: 3 questions, e.g. "In our company, reporting an unusual transaction takes a lot of time" (reversed) (α = .81)
- Client knowledge: 6 questions, e.g. "In our company, we have sufficient knowledge of the client to determine whether a transaction is unusual" (α = .84)
- Reporting culture: 6 questions, e.g. "In our company, you are strongly encouraged to report unusual transactions" (α = .79)
- Reporting conduct: 4 questions, e.g. "Unusual transactions remain frequently unreported" (reversed) (α = .83)
- Reputation: 4 questions, e.g. "Our company possesses a very favorable reputation for its quality of services" (α = .80)
- Client satisfaction: 1 question, "To what extent are clients satisfied with the company?" (1 = Much less than the competitors, 7 = Much better than the competitors)

Because the questions in the survey are aimed at reporting unusual transactions, it should be taken into account that respondents have sometimes given hypothetical answers. Since the number of reports is low, not every employee has reported an unusual transaction so far. Investment firms also differ in the degree to which they (think) unusual transaction can occur in their firm. For example, asset managers do not see any entries because transactions take place via a custodian bank. Other firms only provide consult and others have a head office that conducts client research and transactions. The interviews also revealed a number of safeguards that may reduce the chance of unusual transactions, such as having a fixed contra account, not being allowed to carry out transactions by clients, extra checks by the custodian bank, low-risk clients and institutional clients under supervision. Some of the questions from the survey were therefore less relevant for some firms and possibly filled in neutrally, for example the question about the origin of assets when a firm does not manage any assets. To give more substance to the survey results, in total 12 semi-structured interviews were conducted among employees and compliance officers at 4 investment firms.

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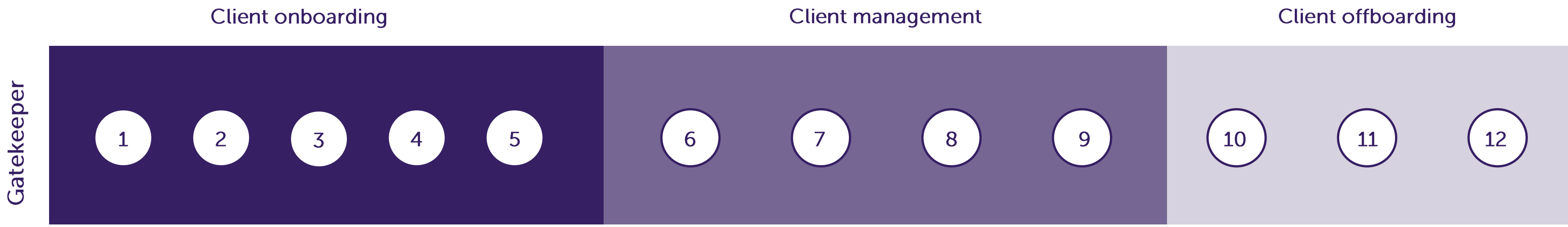
Reporting unusual transactions: when do I need to be alert?

What is considered to be an unusual transaction? What can you report to prevent money laundering and terrorist financing?

An unusual transaction includes more than just a deviating transaction pattern. A report can be filed when something unusual is suspected. This does not implicate that a client is also a suspect. This overview provides an example of moments when you need to be alert to unusual transactions. If you have any doubt whether a situation concerns an unusual transaction, always contact your compliance officer.



1. The client does not give full disclosure
2. The client is situated in a high risk country
3. The origin of assets and/or UBO is untraceable
4. There is reason to believe an unusual transaction took place in the past
5. Due to integrity risks the client is not accepted
6. There are deviating deposits and withdrawals (in size and nature)
7. The origin of assets remains unclear and the client will not give full disclosure
8. Withdrawals do not fit the investment goal or regular transaction pattern
9. Information is changed during services (address, contra account, authorizations)
10. It is unclear why a client wants to discontinue services (prematurely)
11. The reason to discontinue services does not match the client profile (investment goal, risk appetite)
12. The client moves to an investment firm situated in a high risk country

By reporting unusual transactions you contribute to a fair financial sector