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What is Financial Crime Risk?

Of the many vulnerabilities and threats to the financial services sector, financial crime risk has emerged as a pervasive, yet widely misunderstood category of risk. As consumers, governments, and the financial industry have gained familiarity with various forms of financial crime, financial services organisations have seen that the underlying risk of financial crimes not only includes the direct action taken by criminals, but also includes the impact of deterrence, detection, and resolution on the organisation and its customers.

But what is financial crime risk? As the term is only now becoming part of the lexicon of the financial services sector, establishing a single definition will help guide the discussion and eliminate misunderstanding:

A financial crime is a ***regulatory, reputational, or monetary act or attempt*** against financial services institutions, corporations, governments, or individuals by internal or external agents to steal, defraud, manipulate, or circumvent established rules.

The essential aspect of this definition is the impact beyond the actual financial criminal act itself, because financial institutions feel the effect of these incidents far beyond the specific incident or situation. Working with this definition, there are three main are as of financial crime risk posed to financial services organisations:

• Criminal Acts: These include actual financial crimes and explicitly illegal acts, such as account takeover, insider trading, illicit employee activity, terrorist financing, and market manipulation. Most financial institutions and consumers are able to identify these types of activities and their downstream effect.

• Compliance & Monitoring: Activities such as trading and sanctions compliance, suspicious activity monitoring, and Know Your Customer (KYC) requirements are typically driven by regulations and are traditionally seen as just the cost of doing business. More recently, financial services organisations have come to understand how technology and processes affect investigators, compliance officers, and customers. Continued investment in intelligently combining technology with processes is now often mandated in an effort to limit regulatory fines, sanctions violations, and other financial crime risks. This also helps financial services organisations to gain additional value from compliance programs, either through greater efficiencies or by leveraging collected data in sales and marketing activities.

• Intangible Impacts: These “softer” effects include the indirect impact of prevention, the burden placed on internal processes, as well as the possible negative impact of customer disruption and reputational damage. Additional examples of less tangible impact include finding extra resources to support timely regulatory filings or examinations, increased data storage needs, and the “cost” of enforcing audit and supervisory procedures such as ongoing education and the opportunity cost of neglecting “regular” activities. Often, these opportunity costs are not calculated in the total cost incurred to an institution despite their significance.

Dealing with a Growing and Public Problem

With financial crime, any news is bad news, and there has been no shortage of bad news lately. Whether the topic is the loss of monetary or informational assets, regulatory scrutiny, or costly reputational damage, the issue of financial crime and the wider effects on the financial industry are in the headlines now more than ever before. But while the effects of financial crime are apparent, efforts to prevent it are not as easily executed.

Financial services organisations have the difficult task of effectively identifying the greatest risks to themselves and to their customers, protecting both parties against unnecessary risks and satisfying regulatory requirements for greater transparency, awareness, and consolidation of information across the organisation. For many such organisations, this challenge is compounded by a stagnant or even shrinking budget allocation, making these tasks even more daunting. Financial services organisations are increasingly realising that they must move beyond the traditional reactive and siloe’d approach toward a more comprehensive Financial

Crime Risk Management strategy.