



Effective transaction monitoring for investment management



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Executive summary

Across the financial services industry, many firms have struggled to identify and implement a commensurate level of coverage from their Anti-Money Laundering (AML) transaction monitoring programmes. No more so than those firms across the investment management landscape.

In this paper, Ernst & Young LLP (EY UK&I) identifies the unique challenges that many firms across investment management face, and why commonly used approaches to automated AML transaction monitoring may be unsuitable.

We believe that new approaches need to evolve relevant to the type of firm providing services across the domain, which reflect the risk exposure, custody of funds and knowledge held by that firm about their clients.

Introduction

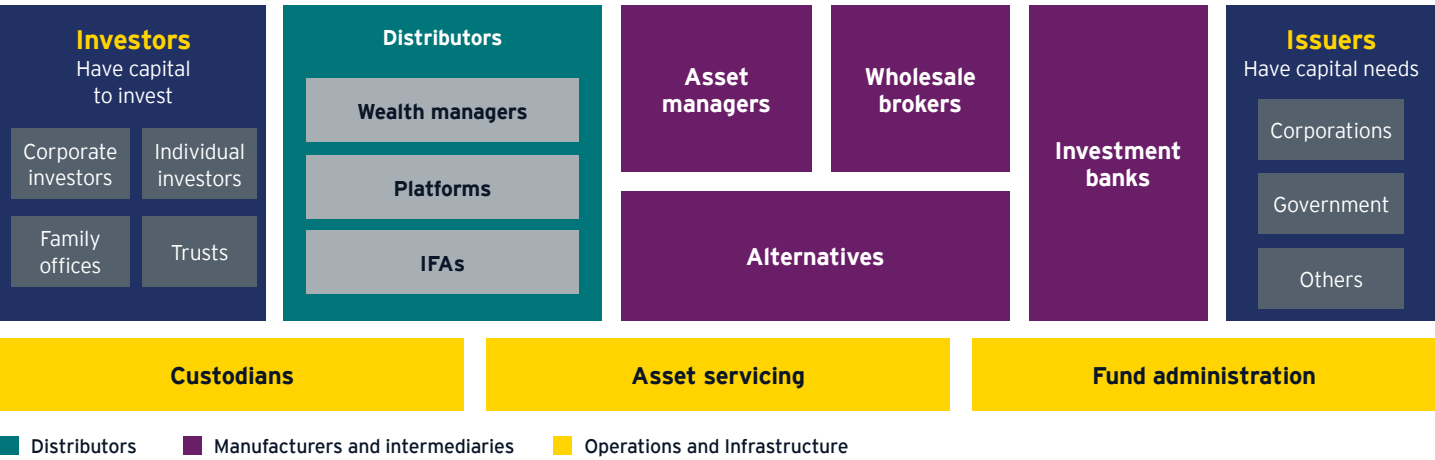
The landscape of investment management firms

Investment management comprises a variety of interconnected firms that enable end-to-end investment flows, from investors supplying capital to issuers in demand for it. In between, firms perform various roles, including wealth and asset management, alternative investment management, and wholesale brokerage, among others. Larger firms often occupy various roles, while smaller firms specialise in one area of the ecosystem.

All firms are underpinned by an infrastructure layer, enabling operations by providing custodian and transfer agency services. While other investment management firms’ focus is to grow the capital of their clients on the buy-side or resolve their capital needs on the sell-side, firms in the infrastructure layer focus on providing the operational support for all investment activity.

The multitude of roles interoperating simultaneously creates complexity, fragmentation and interdependencies, leading to a distinct set of challenges in establishing and maintaining financial crime controls.

The diagram below provides an overview of the range of firms involved in the investment management ecosystem.



AML transaction monitoring

AML transaction monitoring is a key control for detecting unusual patterns of potential money laundering or terrorist financing. In investment management, however, it has created uncertainty. Financial crime teams are assessing whether automated AML transaction monitoring is for transactions linked to investment activity, and if so, to what extent. This includes understanding the responsibilities of both their own firm and supporting operations and infrastructure providers.

Investment firms currently apply various approaches to conduct automated monitoring. These approaches range from firms not maintaining any automated monitoring capability and relying on third parties, through to the implementation of automated solutions designed primarily for banks.



Challenges in establishing effective AML transaction monitoring

The key challenges faced by firms in establishing an effective AML transaction monitoring approach are intrinsic to investment management, and they fundamentally impact the ability to mitigate risks related to money laundering and other illicit activities. Below, we outline the three main challenges.

1. Reliance on third parties

Firms relying on third parties often expect or assume that other firms in the investment ecosystem – such as distributors or custodians – monitor the transactions underpinning their investment activity. Since these firms play a role in the investment flow and must adhere to AML regulations, they are expected to perform this function.

We have observed that firms typically expect third parties to monitor transactions, but this expectation is not clearly aligned or formally agreed between parties. This may lead to a circular reliance, where each party assumes that the others are conducting monitoring of some form, while in reality they are not.

Under certain regulatory guidance, wealth and asset management firms should not outsource their responsibility for transaction monitoring to other firms.^{1,2} The expectation is that, in cases where third parties are used to meet this regulatory requirement, the necessary formal agreements and oversight must be in place.

2. Visibility of end-to-end transactions

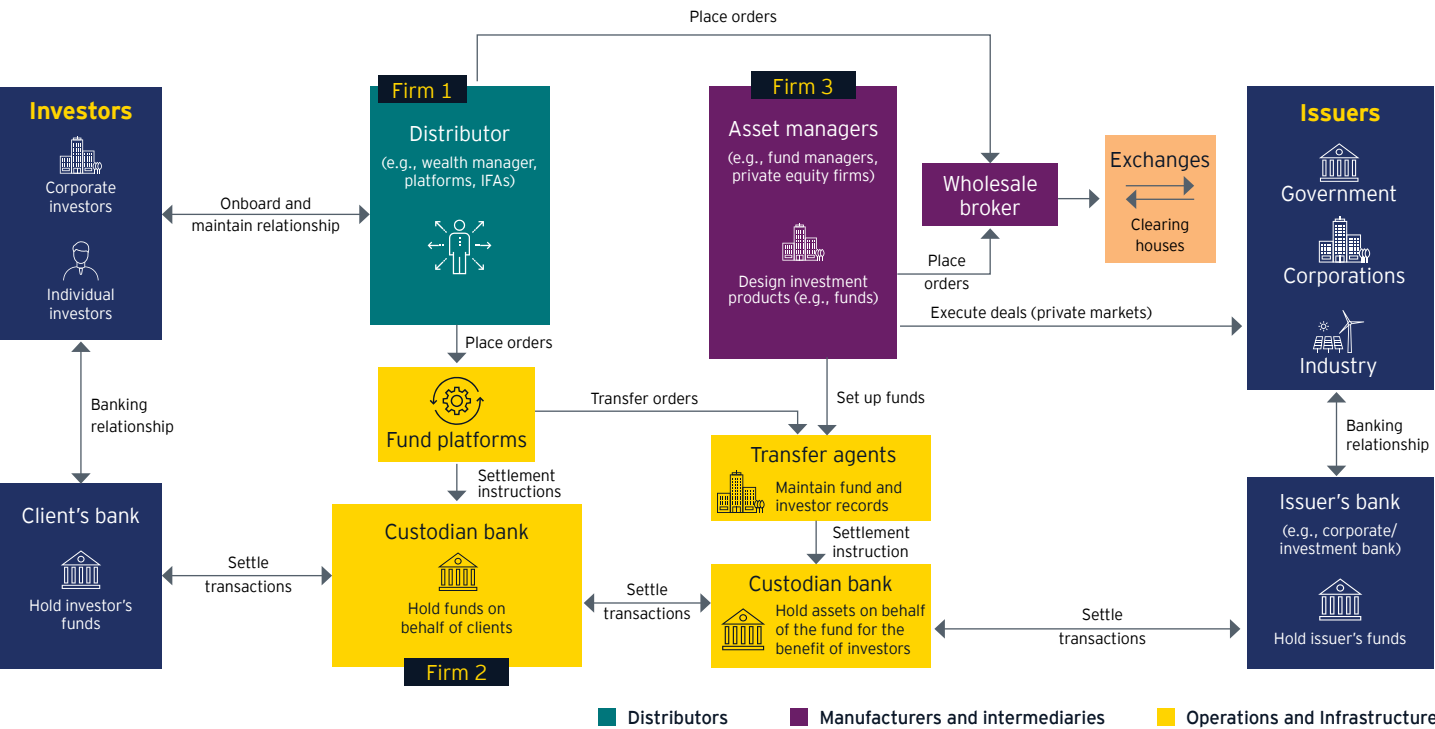
Firms may not have access to all the data required for implementing end-to-end automated monitoring for their clients because funds travel through multiple layers of entities, from the underlying investors to the issuers.



¹ Portfolio letter: Asset Management & Alternatives – Supervisory Strategy, <https://www.fca.org.uk/publication/correspondence/asset-management-alternatives-portfolio-letter-2025.pdf>

² Dear CEO letter: FCA expectations for wealth management & stockbroking firms, <https://www.fca.org.uk/publication/correspondence/dear-ceo-letter-fca-expectations-wealth-management-stockbroking-firms.pdf>

The diagram below provides a high-level overview of these firms and their interactions through an investment’s lifecycle, along with a high-level view of end-to-end transaction flows.



In a scenario where firm 1 holds the relationship with the client, conducts Know Your Customer (KYC), provides investment advice, and manages an investment portfolio. Firm 2 receives settlement instructions from fund platforms and settles transactions on behalf of the underlying investor.

Neither firm 1 nor firm 2 would have all the data required to determine the usual behaviour (based on KYC) or have direct access to transactional data necessary for conducting effective monitoring. Firm 3 would not have visibility into the overall transactional activity or KYC information for the underlying investor but would likely have closer contact and more information about the issuers. Essentially, none of the firms involved in this process have an end-to-end view of the transactional data flows in this ecosystem.

We have observed that the lack of data across the end-to-end transactional flow is sometimes cited as a reason for not conducting monitoring. This is often accompanied by the belief that other firms in the ecosystem are better positioned and have better access to data to perform this function. However, these assertions typically lack an adequate assessment of whether those firms can or do fulfil this role, undermining the potential for creating cohesive controls, based on collaboration across multiple firms.

3. Use of bank-based off-the-shelf solutions

We have observed that firms using solutions with out-of-the-box configurations originally designed for banks have experienced ineffective and inefficient outcomes. The configurations of banks’ automated transaction monitoring systems are not directly transferable to investment managers. In many instances, wealth and asset management firms have replicated the banks’ coverage for these systems, including thresholds.

These configurations are unlikely to reflect the unusual behaviour among investment management clients. As a result, despite the investments these firms have made, the effectiveness of their controls has been limited.

Given the current state of transaction monitoring controls in investment management – characterised by third-party reliance, data fragmentation and inappropriate system configurations – a money laundering typology involving the underlying investor, the fund administrator and issuers of securities is unlikely to be detected.

Regulatory expectations

The regulatory guidance on transaction monitoring for investment firms is similar to the requirements for other financial institutions in the UK.³ However, there is sector-specific guidance for a number of the following types of firms.

- Discretionary and advisory investment management
- Execution-only stockbrokers
- Non-life providers of investment fund products
- Wealth management
- Life assurance and life-related protection, pension and investment products

The expectation is that firms should identify the applicable specific guidance and consider it in conjunction with the general points summarised below.

As a general principle, transaction monitoring regulatory requirements are not prescriptive and are fundamentally based on a risk-based approach. This means that the firm's risk assessments play a significant role in determining the level of controls required.

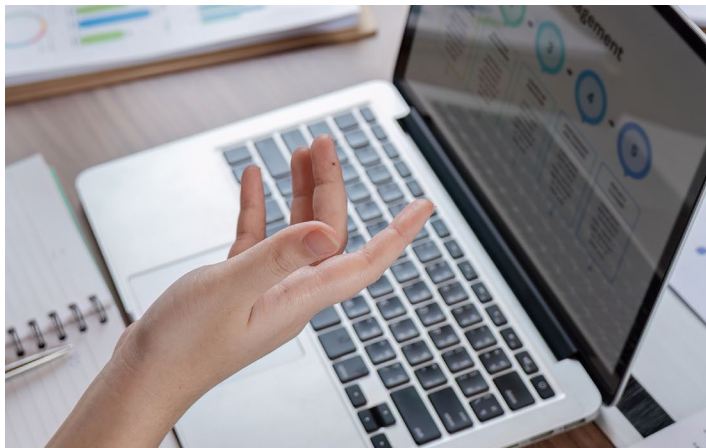
The summary below outlines key points often raised by financial crime teams in investment management. This is based on the transaction monitoring guidance for financial firms outlined in the JMLSG (Part 1), which is relevant for all financial firms.⁴

1 Ongoing monitoring

Firms must conduct ongoing monitoring of the business relationship with their clients, scrutinising transactions to ensure they are consistent with the firm's knowledge of the clients, their business and their risk profile. This includes identifying unusual activities that may indicate money laundering or terrorist financing. The essentials of any monitoring system are to flag up transactions or activities for further examination, ensure these reports are reviewed promptly by the right person(s), and take appropriate action based on the findings.

2 Automated vs. manual monitoring

Firms may employ manual or automated systems depending on their business scale. Automated systems can enhance manual processes, particularly for high transaction volumes, but must be regularly reviewed to ensure they remain effective.



3 Third-party reliance

Although firms may rely on third parties to carry out customer due diligence measures, firms remain ultimately responsible for compliance with the Money Laundering Regulations. Clear contractual agreements with third parties should outline expectations and responsibilities related to transaction monitoring.

4 Dynamic process

Monitoring is a dynamic process that requires regular review of the configuration parameters and thresholds to ensure they remain effective. Firms must document monitoring arrangements and any changes made.

5 Training and awareness

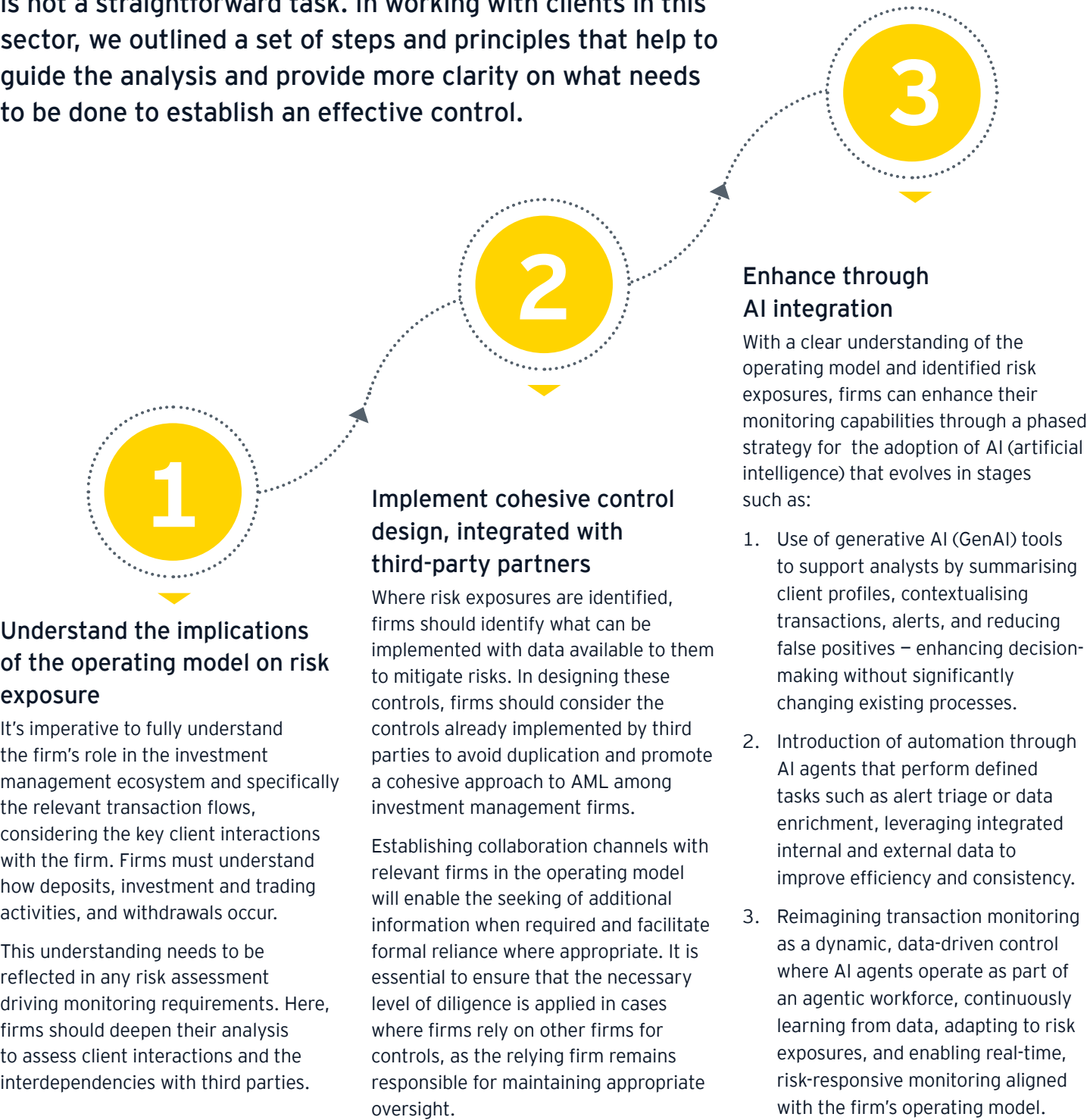
Staff should receive sufficient training to recognise unusual activities and understand the monitoring processes in place. Regular training updates should be provided to keep staff informed of evolving risks and typologies. It is important to note that training cannot be assumed as a replacement for regular monitoring activities.

6 Governance and oversight

Firms should establish a governance framework for overseeing monitoring processes, including the configuration parameters. This should involve defining responsibilities, measuring the effectiveness of monitoring controls, and implementing changes to address emerging money laundering and terrorist financing risks.

What can firms do?

We have been supporting investment managers in determining their monitoring requirements. Given the particularities of each firm, designing a monitoring control is not a straightforward task. In working with clients in this sector, we outlined a set of steps and principles that help to guide the analysis and provide more clarity on what needs to be done to establish an effective control.



³ The Joint Money Laundering Steering Group Guidance, <https://www.jmlsg.org.uk/guidance/current-guidance/>

⁴ The Joint Money Laundering Steering Group Guidance, Part 1, https://www.jmlsg.org.uk/wp-content/uploads/2025/08/JMLSG-Guidance-Part-I_June-2023-updated-Nov-2024.pdf

In designing transaction monitoring controls, investment management firms should consider five key principles:

1. Proportionality – Transaction monitoring controls must be commensurate with and relevant to the characteristics of the firm, including the investment products offered and the client base and type.

2. Defensibility – Firms should establish a defensible rationale for their transaction monitoring scope, including the use and extent of automation.



3. Cohesion – Firms should avoid duplicating controls, specifically where another firm within the operating model has already established a control and implements it effectively for the same clients and transactions.

5. Collaboration – Given the intertwined and multilayered nature of financial transactions across the investment management ecosystem, collaboration is essential. Firms should avoid operating in silos. Collaboration at the MLRO and operational levels strengthens controls and improves the detection of suspicious activity.

4. Responsibility – Firms cannot outsource their responsibilities by relying on third parties. Firms should conduct sufficient due diligence and establish oversight to ensure that third-party controls meet the firm’s requirements.





Ernst & Young LLP (EY UK&I) supports investment management firms in improving financial crime controls through short-, medium- and long-term strategies. We assess and benchmark processes, guide vendor decisions and lead the cultural changes necessary for strategic transformations and institutional growth.


We have extensive experience in assisting investment managers with a range of financial crime challenges. This includes developing operating models, policies and procedures, as well as technology and data solutions to improve efficiency, effectiveness and customer experience.

To explore how we can strengthen your financial crime controls, please contact us to schedule a session.

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