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The Ultimate Guide to Due Diligence in Financial Services

Introduction

In the financial services sector, the strength of a company's regulatory licenses directly influences its value and potential for growth. An acquisition or investment in a regulated financial institution is fraught with risk if the company cannot meet ongoing compliance requirements or if the firm is at risk of losing its license.

At Buckingham Capital Consulting, we understand that M&A transactions and investments in regulated industries hinge on regulatory certainty. With this in mind, our due diligence processes ensure that you are making informed decisions backed by a comprehensive understanding of the target's regulatory posture and its ability to maintain its operational license.

Our due diligence process provides a comprehensive analysis of compliance, financial health, and operational stability for investment and M&A activities in the financial services sector. This guide is designed to offer an in-depth understanding of regulatory due diligence for both buy-side and sell-side transactions, focusing on financial services.

Given the complexities of modern financial services, due diligence has become a critical component of any investment or acquisition process. It ensures that potential risks are identified early and mitigated, helping businesses avoid non-compliance penalties and operational inefficiencies. This guide provides you with the best-in-class approach to navigating the due diligence process, ensuring you achieve long-term success in your transactions.

The Financial Services Due Diligence Process: A Detailed Overview

Due diligence forms the bedrock of understanding any target's legal, regulatory, operational, compliance and financial viability. Whether you are involved in a buy-side or sell-side transaction, our due diligence services focus on identifying potential risks, financial discrepancies, and operational inefficiencies. The due diligence process is structured to evaluate a target's compliance culture, governance structure, risk management, and regulatory reporting standards.

1. **Buy-Side Due Diligence:** For buyers, our due diligence ensures that the target company is fully compliant with the regulations governing its operations. This helps identify hidden risks that could affect the transaction's value, mitigate potential penalties, and ensure smooth integration post-acquisition. The buy-side process includes the review of licenses, compliance records, and regulatory audits to ensure there are no existing issues that could cause liabilities after the deal.
2. **Sell-Side Due Diligence:** For sellers, our due diligence process helps prepare the business for sale by providing an in-depth review of its regulatory standing. This allows sellers to identify potential gaps in compliance that may affect valuation and gives them the chance to rectify these issues before listing the company for sale. This proactive approach ensures that the business is ready for a smooth transaction, minimising delays or issues during the buyer's due diligence process.

Key Components of Financial Services Due Diligence

Financial services due diligence involves a thorough review of a target company's financial health, operational framework, risk management, and compliance. A successful financial services due diligence process requires an in-depth understanding of the target's financial performance, operational viability, governance, and market standing.

1. **Financial Health Assessment:** This includes reviewing the target's financial statements, cash flow, assets, liabilities, and profitability. We assess the company's financial position, profitability trends, and identify any

financial risks or discrepancies. This ensures that the target is financially stable and offers a clear understanding of potential liabilities and future growth potential.

2. **Governance Structure and Risk Management:** A detailed evaluation of the target company's governance structure is essential for understanding how responsibilities are allocated and how risks are managed. This includes reviewing the company's risk management framework, including internal controls and how they comply with risk management best practices, such as the Three Lines of Defence model.
3. **Operational Efficiency and Compliance Culture:** We evaluate the target's internal processes and operational efficiency, ensuring that the company's infrastructure supports long-term growth. This also includes reviewing its compliance culture—assessing the effectiveness of internal policies related to anti-money laundering (AML), know your customer (KYC), and data protection, alongside employee training on regulatory matters.
4. **Licenses and Regulatory Standing:** Ensuring that the target holds the appropriate operational licenses and meets all required regulatory filings is essential. We review the company's license portfolio and regulatory filings to ensure it operates legally within its respective markets. This includes identifying any potential compliance issues that could affect operations or future growth.
5. **Market Position and Competitor Landscape:** We assess the target's market position and competitive landscape within the financial services sector. This includes analysing its competitive advantages, market share, and potential risks posed by competitors. We examine the sustainability of its business model and future growth opportunities.
6. **Legal and Contractual Review:** We conduct an extensive legal review of the target's corporate structure, contracts, and any ongoing or potential litigation. This ensures there are no legal risks that could affect the target's operations or its ability to comply with industry regulations.
7. **Third-Party and Vendor Risk:** We assess how well the target manages third-party and vendor relationships. This includes reviewing outsourcing arrangements, partner contracts, and the compliance of third parties with relevant regulatory frameworks, as non-compliant partners can pose significant risks.
8. **Operational and Financial Compliance:** We evaluate the target's compliance with operational processes and financial reporting standards, ensuring that it adheres to best practices for financial management. This also includes verifying the accuracy and reliability of financial statements and audit trails.

Financial Services Due Diligence Checklist

- **Financial Review:**
 - Review financial statements, cash flow, assets, and liabilities.
 - Assess the target's profitability, financial stability, and potential risks.
 - Verify financial audits, tax filings, and any past financial discrepancies.
- **Governance and Risk Management:**
 - Evaluate the organisational structure and risk management framework.
 - Review internal controls and compliance with best practices.
 - Assess the effectiveness of the Three Lines of Defence model.
- **Operational Efficiency:**
 - Review the target's operational processes and scalability.
 - Evaluate internal policies and training programs for regulatory compliance.
- **Licensing and Regulatory Filings:**
 - Review the company's licenses and ensure all required permits are in place.
 - Identify any regulatory violations or pending investigations.

- **Market Position and Competitor Landscape:**
 - Assess the target's competitive position within the financial services market.
 - Review its market share, growth opportunities, and potential risks.
- **Legal and Contractual Review:**
 - Review legal documentation, contracts, and litigation history.
 - Identify any legal risks that may affect the target's future viability.
- **Third-Party Risk Assessment:**
 - Assess the compliance and operational risks posed by third-party vendors.
 - Review partner contracts and outsourced functions.
- **Financial and Operational Compliance:**
 - Ensure compliance with financial reporting standards and industry regulations.
 - Verify the target's operational processes and financial audit trails.

Conclusion

Due diligence is crucial for both buy-side and sell-side transactions in the financial services sector. At Buckingham Capital Consulting, we provide comprehensive due diligence services that ensure your investment or acquisition is regulatory-compliant, financially stable, and operationally sound. Our approach is built on extensive industry experience, meticulous attention to detail, and a commitment to mitigating regulatory risks. Whether you're investing in or acquiring a regulated firm, we ensure that your transactions are supported by solid regulatory foundations, enabling confident decision-making for the long-term success of your business.

By combining thorough regulatory assessments with financial and operational reviews, we ensure that your investment process is backed by actionable insights and strategic intelligence, providing you with a competitive edge in the market.

Due Diligence Services at Buckingham Capital Consulting

At Buckingham Capital Consulting, we offer specialised due diligence services that ensure the regulatory, financial, and operational health of your investments. Our comprehensive approach is focused on financial services and regulated sectors such as banking, fintech, crypto-asset, e-money institutions (EMIs), and payment institutions (PIs). With over 13 years of experience, we provide thorough insights that help clients navigate the complexities of M&A transactions and investment evaluations, mitigating risk and optimising deal outcomes.

We understand that in the financial services sector, the value of firms is often tied directly to their regulatory licenses and their ability to maintain compliance over time. This is a critical area of focus for us. A firm's regulatory standing—the strength of its license and its capacity to retain that license—can significantly impact its market value. That's why our regulatory due diligence services are designed to provide in-depth analysis of license viability, compliance frameworks, and the operational risks tied to maintaining such licenses.

We work with both buy-side and sell-side clients, ensuring that all regulatory aspects are thoroughly examined, allowing for informed decision-making and risk mitigation in every transaction.

Our Services

1. **Regulatory Due Diligence:** We evaluate a target's adherence to local and international regulations, ensuring that its operations align with industry standards. We focus on assessing the health of regulatory licenses, compliance audits, and past regulatory filings, ensuring no hidden risks or potential non-compliance penalties that could affect the transaction.

2. **Financial Due Diligence:** We verify the financial standing of the target, including an assessment of its financial records, tax obligations, and accounting practices. This service ensures that the financial health of the target is in order and provides a clear understanding of potential liabilities and risks.
3. **Legal Due Diligence:** We conduct an extensive review of the target's legal documentation, including corporate records, material contracts, and litigation history. This helps uncover any legal issues that could affect the future viability of the business and its ability to comply with regulatory standards.
4. **Operational Due Diligence:** We assess the target's internal processes, risk management systems, and overall operational efficiency. This includes ensuring that the firm's operational framework supports its regulatory requirements and assessing whether the infrastructure can handle future growth without compromising compliance.
5. **Technology Due Diligence:** For fintech and crypto firms, we evaluate the target's technology stack, focusing on cybersecurity, scalability, and compliance with industry-specific regulations. We ensure that the company's technology systems are not only secure but also aligned with evolving regulatory standards.

Why Buckingham Capital Consulting?

Expertise and Experience: With over 13 years of experience in financial services and regulatory compliance, we have developed unmatched expertise in navigating complex compliance landscapes. Our team of seasoned professionals is committed to providing you with actionable insights that ensure your due diligence process is thorough, efficient, and effective.

Focus on Regulatory License Health: In the financial services sector, the value of a firm is often tied directly to its ability to maintain its regulatory licenses. Our regulatory due diligence is built on the assessment of a target's license strength, ensuring that your investment or acquisition is protected from the risks associated with non-compliance, regulatory penalties, and operational disruptions.

Tailored Solutions: We understand that each transaction is unique. Whether you're buying or selling, our due diligence services are customised to meet your specific needs. We focus on the regulatory aspects that are most critical to your investment strategy, ensuring that all potential risks are addressed.

Proven Track Record: We've successfully helped hundreds of clients navigate regulatory compliance challenges and due diligence assessments. Our track record speaks for itself, with clients across fintech, banking, electronic money institutions, payment institutions, crypto-assets, and other sectors benefiting from our regulatory expertise.