

## **ANTI-MONEY LAUNDERING FOR INSURANCE**

### **Hands-on Challenges for Life Insurers**

**“According to court documents and related interviews, federal law enforcement officials have discovered that Colombian drug cartels bought life insurance policies in continental Europe, the United Kingdom, and in smaller jurisdictions such as the Isle of Man, to launder the proceeds of drug trafficking. Using narcotics proceeds from the United States and Mexico, the traffickers:**

- **Purchased 250 life insurance policies in the Isle of Man alone.**
- **The insurance policies, worth as much as \$1.9 million each, were sometimes taken out in the names of cartel associates and members of their families.**
- **The traffickers would typically cash out all or part of the Isle of Man policies prematurely, in some cases after only a year, paying penalties of 25 percent or more.**
- **The penalties, however, merely represented a “business cost” of using the insurance policies to launder the illicit narcotics proceeds.**

**Thus far, federal law enforcement officials have seized more than \$9.5 million in Florida in connection with the investigation. The policyholders were:**

- **Authorizing unrelated third parties to withdraw money from the cash value of their policies.**
- **Were frequently cashing out their policies early.**

**A review of Suspicious Activity Reports filed with the Financial Crimes Enforcement Network (FinCEN) also reveals instances in which financial institutions have reported the suspected use of insurance products for the purpose of laundering the proceeds of criminal activity. During the past five years, a number of Suspicious Activity Reports were filed that reference the use of an insurance product in suspected money laundering activity. For example:**

- **Several reports describe as suspicious the large, lump-sum purchase of annuity contracts, followed almost immediately by several withdrawals of those funds. In some cases, the entire balance of the annuity contract was withdrawn shortly after the purchase of the contract.**
- **Other reports detail suspicious loans taken out against an annuity contract.**
- **Life insurance premiums were paid by unrelated third parties.”<sup>1</sup>**

The excerpt above helps explain why the U.S. Treasury issued special anti-money laundering (AML) rules for the insurance industry last fall, bringing the industry into line with banks and other financial institutions have had to comply with AML for years. The date for compliance was May 2, 2006.

For those of you who aren't quite there yet, this article will address the risks facing life insurers around AML and some of the challenges with implementing the policies and procedures called for in the regulations.

## REQUIREMENTS

The regulations require insurers who handle “covered products” – those that have cash or investment values (e.g., whole life, universal life, annuities), to develop not only AML rules, but also Know Your Customer rules (Customer Identification Program or CIP). The regulations require insurers to develop policies and procedures for both AML and CIP. Given the volume of transactions many companies have around their premium and disbursement activities, automated solutions will almost always be a requirement. And while there are several software solutions available, and they can make compliance with the regulations much easier, we won't have time to get into those in this article.

The boilerplate requirements of the regulations require you to develop an AML program with:

- A risk-based policy
- Designate a qualified Compliance Officer
- Provide timely, adequate training
- Provide for a regular, independent review

These policies must allow for recognizing, capturing, documenting, and reporting suspicious activities as defined under the regulations and be approved by senior management (whereas banks must have Board approval).

## PENALTIES

The AML regulations (Dept. of the Treasury 31 CFR Part 103) spring from the Bank Secrecy Act and the USA Patriot Act, which require financial institutions to capture, retain, and report certain transactions that could be used by criminals or terrorists to launder money or direct it to prohibited entities. Penalties for failure to comply with these acts range from \$10k to \$1mm per infraction with the possibility of attendant criminal charges for both individuals and corporations. And while insurers are just now having to comply with these regulations, banks and broker/dealers have been following AML rules for years. So a word to the wise might be useful here since 60% of the firms examined by the SEC for AML had mistakes or failures leading to, in some cases, substantial fines:

- AML compliance procedures were not approved in writing by senior management
- There wasn't an independent audit or compliance review of the AML program
- Deficiencies in customer identification programs
- Failed to implement procedures and controls to detect and report suspicious activity

- No documentation of investigation leading to the filing of suspicious activity reports
- No AML training for employees
- Did not collect certifications and similar information from foreign banks
- Didn't screen old accounts and third-party wire transfers against the OFAC list
- Some of the fines incurred, especially where there was deemed to be "willful failure" range from \$10k to \$80 million.

## **CHALLENGES**

### Risk Analysis

The good news is, the regulations give you – no, require you – to base your policies, procedures, and controls on a Risk Analysis of your business. So this is your first challenge. If you happen to be part of an insurer whose field force sells SEC-registered products (securities), you probably had a head start. And the better your risk analysis, the easier it will be to develop effective controls with the proper scope. Some of the risk items to consider:

- Product mix
- Geographical distribution
- Distribution methods
- Type of clients
- Premium receipt options
- Disbursement options
- Administration structure

### Compliance Officer

The next challenge is the compliance officer. In many companies, the "compliance officer" is often the person responsible for market conduct compliance, privacy compliance, HIPAA compliance, Sarbanes-Oxley compliance, etc. The same officer wears several different compliance hats. However, for AML, this officer must have the authority to, among other things, tell the field that an applicant must be refused because their name did not pass the CIP identity check or showed up on an OFAC (Office of Foreign Assets Control) match as a possible SDN (specially designated national).

### Training

One of the biggest challenges we have seen is the training requirement. Not just for the home office staff, but for the field. The agent is on the front line of AML and Insurers, not agents, are responsible for enforcing AML policies in the field and reporting activity that originate in the field. And many companies use independent agents. Whether independent or captive, many agents are going to see the AML regulations as just another way the home office is making it more difficult for them to earn a living. And how do you assure that all of the agents in the myriad geographical locations with varying degrees of loyalty to your company actually took the training once you decide what it will be?

- The actual training needs to be not just on the AML regulations, but also on your company's specific policies, procedures, and controls around AML.
- You must be able to document that both home office and field personnel successfully took the training. And that the training is repeated regularly as needed.

Fortunately, LIMRA, LOMA, and other industry groups have developed on-line training programs for field personnel which provides documentation for you. But this is one of the issues that your risk analysis should take into consideration because these programs don't include your specific policy and controls.

Also included in the training programs should be "red flags" – transactions attempted under conditions that both agents and home office staff should be watching for, such as:

- The customer is reluctant or refuses to reveal any information concerning his or her identity, type of business and assets, or business activities, or furnishes unusual or suspect identification or business documents.
- The customer exhibits a lack of concern regarding risks, commissions, or other transaction costs.
- The customer's account shows numerous currency or cashiers check transactions aggregating to significant sums.
- The customer makes a funds deposit for the purpose of purchasing a long-term investment followed shortly thereafter by a request to liquidate the position and transfer of the proceeds out of the account.
- The customer requests that a transaction be processed in such a manner to avoid the firm's normal documentation requirements.
- Attempt to borrow maximum cash value of a single premium policy soon after purchase.
- The customer's account has inflows of funds or other assets well beyond the known income or resources of the customer.
- The customer is attempting to make a purchase that appears to be inconsistent with his/her needs.
- The customer terminates a product early, especially at a cost to the customer, or where cash was tendered and/or the refund check is directed to an apparently unrelated third party.
- The customer exhibits little or no concern for the investment performance but much concern about early termination features of the product.

Another critical facet of the training has to be that the company, including the agent, is NOT allowed to notify the applicant or policyholder that their name has been reported to FinCEN under a Suspicious Activity Report (SAR) or Form 8300 (for cash transactions surpassing the threshold).

#### Audit

A key challenge is the regular "independent" review. The regulations only require that someone who is independent of the AML activities be the one who performs the review.

Do you have your internal audit group perform the review, your external auditor, a consultant, or just another department? And how often is “regular” enough? That question should be answered as part of your risk analysis.

### Suspicious Transactions

AML is not just about new business applications. One of the larger challenges for large companies is tracking and reporting “suspicious transactions.” These could be defined as those which an insurer is required to report if it knows, suspects, or has reason to suspect that the transaction, or a pattern of transactions:

- Involves funds derived from illegal activity or is intended or conducted to hide or disguise funds or assets derived from illegal activity.
- Is designed, whether through structuring or other means, to evade the requirements of the Bank Secrecy Act.
- Has no business or apparent lawful purpose, and the insurance company knows of no reasonable explanation for the transaction after examining the available facts.
- Involves the use of the insurance company to facilitate criminal activity.

Such transactions involve not only premium/cash equivalent receipts, but also any transaction that requires the insurer to issue a check to an applicant or policyholder. This will usually require packaged or internally developed software solutions to monitor transactions identified in the risk analysis – which should include cancellations, not takers, declines, withdrawals, and incompletes.

### 314(a) Requests

One of the AML requirements that could be easy to overlook is the 314(a) requests from FinCEN. These are automated requests from FinCEN to you that require you to check your data base for specific entities. FinCEN provides a list to financial institutions of people and organizations that law enforcement would like to locate and review transactions:

- Financial institutions are required to cross check customer lists against the list provided and report any “hits” within two weeks
- A record should be kept that documents that the list was checked for future audits, but FinCEN does not want companies to keep a copy of the actual Master People or Master Business file

These are not inconsequential requests. So far, via the 314(a) process, FinCEN has discovered and/or issued the following:

- 1,888 New Accounts Identified
- 3,080 New Transactions
- 1,091 Grand Jury Subpoenas
- \$14mm Total Dollar Amount Located

The above challenges are by no means a comprehensive list of issues to be addressed in your AML program. They are just some of the more problematical issues that have turned up in our efforts to help insurers implement a new set of policies and procedures. And you may not have some of the items above in place by May 2<sup>nd</sup>, such as having all the agents trained. However, as of this writing, the SEC doesn't have all its ducks in a row either – the suspicious activity reporting form for insurers, the SAR-IC, is not yet available. As with all new regulations, whether federal or state, it's a work in progress.

<sup>1</sup>*DEPARTMENT OF THE TREASURY  
31 CFR Part 103*

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