

Working Group on Evaluations and Implementation

RISK BASED APPROACH GUIDANCE FOR THE INSURANCE SECTOR

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SECTION ONE:

USING THE GUIDANCE & PURPOSE OF THE RISK-BASED APPROACH

Chapter One: Background and Context

1. In June 2007, the FATF adopted Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing: High Level Principles and Procedures, which includes guidance for public authorities and financial institutions. This was the culmination of extensive consultation between private and public sector members of an Electronic Advisory Group (EAG) established by the FATF.
2. In June 2008, the FATF adopted Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing: High Level Principles and Procedures for the Accountants, Casinos, Dealers in Precious Metals and Dealers in Precious Stones, Legal Professionals, Real Estate Agents and Trust and Company Service Providers, and then in June 2009 for Money Services Businesses.
3. A meeting was held in September 2008 and was attended by organisations representing life insurance companies. An Electronic Advisory Group (EAG) was established for this process and was chaired by Ms Lisa Tate from the American Council of Life Insurance (ACLI) and Mr. Reinhardt Preusche from the European Insurance and Reinsurance Association (CEA). Membership of the Group has consisted of FATF members and observers, as well as representatives from the Life Insurance companies and intermediaries that volunteered to work on the issue of the risk-based approach to combating money laundering and terrorist financing. A list of members is attached at Annex 4.
4. After further international consultation with both public and private sectors, the FATF adopted this RBA Guidance for life insurance companies and intermediaries at its [October 2009] Plenary.

Purpose of the Guidance:

5. The purpose of this Guidance is to:
 - Support the development of a common understanding of what the risk-based approach involves;
 - Outline the high-level principles involved in applying the risk-based approach;
 - Identify characteristics of risks indicating that enhanced mitigation strategies may be warranted;
 - Describe good public and private sector practice in the design and implementation of an effective risk-based approach; and
 - Foster communications between public and private sectors that are conducive to the prevention of money laundering and terrorist financing.
6. However, it should be noted that applying a risk-based approach is neither mandatory nor prescriptive. A properly applied risk-based approach does not necessarily mean a reduced burden, although it should result in a more cost effective use of resources. For some countries, applying a rules-

based system might be more appropriate. Countries will need to make their own determinations on whether or how to apply a risk-based approach.

Target Audience, Status and Content of the Guidance:

7. The Guidance is primarily addressed to public authorities and life insurance companies and intermediaries (*i.e.* life insurance brokers and agents). The overall document is structured into three interdependent sections. Section one sets out the key elements of the risk-based approach and provides the basis for which to interpret section two (Guidance for Public Authorities) and section three (Guidance for life insurance companies and intermediaries). There is also Annex 1, which contains descriptions of additional sources of information.

8. The Guidance aims to set out the key elements of an effective risk-based approach and identifies the types of issues that both public authorities and life insurance companies and intermediaries may wish to consider when applying a risk-based approach.

9. The Guidance recognises that each country and its national authorities, in partnership with its life insurance companies and intermediaries, will need to identify the most appropriate regime, tailored to address individual country risks. Therefore, the Guidance does not attempt to provide a single model for the risk-based approach, but seeks to provide guidance for a broad framework based on high level principles and procedures that countries may wish to consider when applying the risk-based approach with the understanding that this guidance does not override the purview of national authorities.

Chapter Two: The Risk-Based Approach – *purpose, benefits and challenges*

The purpose of the Risk-Based Approach

10. The FATF Recommendations contain language that permits countries to some degree to adopt a risk-based approach to combating money laundering and terrorist financing. That language also authorises countries to permit life insurance companies and intermediaries to use a risk-based approach to discharging certain of their anti-money laundering (AML) and counter-terrorist financing (CFT) obligations. By adopting a risk-based approach, competent authorities and life insurance companies and intermediaries are able to ensure that measures to prevent or mitigate money laundering (ML) and terrorist financing (TF) are commensurate to the risks identified. This will allow resources to be allocated in the most efficient ways. The principle is that resources should be directed in accordance with priorities so that the greatest risks receive the highest attention. The alternative approaches are that resources are either applied evenly, so that all life insurance companies and intermediaries, customers, products, etc. receive equal attention, or that resources are targeted, but on the basis of factors other than the risk assessed. This can inadvertently lead to a 'tick box' approach with the focus on meeting regulatory needs rather than combating ML/TF.

11. Adopting a risk-based approach implies the adoption of a risk management process for dealing with ML/TF. This process encompasses recognising the existence of the risk(s), undertaking an assessment of the risk(s) and developing strategies to manage and mitigate the identified risks.

12. A risk analysis must be performed to determine where the ML/TF risks are the greatest. Countries will need to identify the main vulnerabilities and address them accordingly. Life insurance companies and intermediaries will need to identify higher risk customers, products and services, including delivery channels, and geographical locations. These are not static assessments. They will change over time, depending on how circumstances develop, and how threats evolve.

13. The strategies to manage and mitigate the identified ML/TF risks in life insurance companies and intermediaries are typically aimed at preventing the activity from occurring through a mixture of

deterrence (e.g. appropriate customer due diligence (CDD) measures), detection (e.g. monitoring and suspicious transaction reporting), and record-keeping so as to facilitate investigations.

14. Proportionate procedures should be designed based on assessed risk. Higher risk areas should be subject to enhanced procedures: for life insurance companies and intermediaries, this may include measures such as enhanced customer due diligence checks and enhanced transaction monitoring. It also follows that in instances where risks are low, simplified or reduced controls may be applied.

15. There are no universally accepted methodologies that prescribe the nature and extent of a risk-based approach. However, an effective risk-based approach does involve identifying and categorizing ML/TF risks and establishing reasonable controls based on risks identified. An effective risk-based approach will allow life insurance companies and intermediaries to exercise reasonable business judgement with respect to their customers. Application of a reasoned and well-articulated risk-based approach will justify the determinations of life insurance companies and intermediaries with regard to managing potential ML/TF risks and allow life insurance companies and intermediaries to exercise reasonable business judgement with respect to their customers. A risk-based approach should permit life insurance companies and intermediaries to engage in transactions while effectively managing potential ML/TF risks.

16. Regardless of the strength and effectiveness of AML/CFT controls established by life insurance companies and intermediaries, criminals will continue to attempt to move illicit funds through life insurance companies and intermediaries undetected and will, from time to time, succeed. A reasonably designed and effectively implemented risk-based approach will provide an appropriate and effective control structure to manage identifiable ML/TF risks. However, it must be recognized that any reasonably applied controls, including controls implemented as a result of a reasonably implemented risk-based approach will not identify and detect all instances of ML/TF. Therefore, regulators, law enforcement and judicial authorities must take into account and give due consideration to a life insurance company and intermediaries' well-reasoned risk-based approach. When life insurance companies and intermediaries do not effectively mitigate the risks due to a failure to implement an adequate risk-based approach or failure of a risk-based programme that was not adequate in its design, regulators, law enforcement or judicial authorities should take necessary action, including imposing penalties, or other appropriate enforcement/regulatory remedies.

Potential Benefits and Challenges of the Risk-Based Approach

Benefits:

17. The adoption of a risk-based approach to combating ML/TF can yield benefits for all parties including the public. Applied effectively, the approach should allow life insurance companies and intermediaries and supervisory authorities to be more efficient and effective in their use of resources and minimise burdens on customers. Focusing on higher risk threats should mean that beneficial outcomes can be achieved more effectively.

18. Efforts to combat ML/TF should also be flexible in order to adapt as risks evolve. As such, life insurance companies and intermediaries will use their judgment, knowledge and expertise to develop an appropriate risk-based approach for their particular organisation, structure and business activities.

19. ML/TF risks can be more effectively managed through a risk-based process that assesses all potential risks, and which is built on a true cooperative arrangement between competent authorities and life insurance companies and intermediaries. Without cooperation and understanding between these parties, there can be no effective risk-based process.

20. Money launderers and terrorist organisations have considerable knowledge of life insurance companies and intermediaries and take extreme measures to hide their financial activities and make them indistinguishable from legitimate transactions. A risk-based approach is designed to make it more difficult for these criminal elements to make use of life insurance companies and intermediaries due to the increased focus on the identified higher risk activities that are being undertaken by these criminal elements. In addition, a risk-based approach allows life insurance companies and intermediaries to more efficiently and effectively adjust and adapt as new ML/TF methods are identified.

Challenges:

21. A risk-based approach is not necessarily an easy option and there may be barriers to overcome when implementing the necessary measures. Some challenges may be inherent to the use of the risk-based approach. Others may stem from the difficulties in making the transition to a risk-based system. A number of challenges, however, can also be seen as offering opportunities to implement a more effective system. The challenge of implementing a risk-based approach with respect to terrorist financing is discussed in more detail at paragraphs 37 to 41 below.

22. The risk-based approach is challenging to both public and private sector entities. Such an approach requires resources and expertise to gather and interpret information on risks, both at the country and institutional levels, to develop procedures and systems and to train personnel. It further requires that sound and well-trained judgment be exercised in the implementation within the institution and its subcomponents of such procedures, and systems. It will certainly lead to a greater diversity in practice which should lead to innovations and improved compliance. However, it may also cause uncertainty regarding expectations, difficulty in applying uniform regulatory treatment, and lack of understanding by customers regarding information required to open or maintain a relationship.

23. Implementing a risk-based approach requires that life insurance companies and intermediaries have a good understanding of the risks and are able to exercise sound judgment. This requires the building of expertise within life insurance companies and intermediaries, including for example, through training, recruitment, taking professional advice and "learning by doing". The process will always benefit from information sharing by competent authorities. The provision of good practice guidance is also valuable. Attempting to pursue a risk-based approach without sufficient expertise may lead to life insurance companies and intermediaries making flawed judgments. Companies may over-estimate risk, which could lead to wasteful use of resources, or they may under-estimate risk, thereby creating vulnerabilities.

24. Life insurance companies and intermediaries may find that some staff members are uncomfortable making risk-based judgments. This may lead to overly cautious decisions, or a disproportionate amount of time spent documenting the rationale behind a decision. This may also be true at various levels of management. However, in situations where management fails to recognize or underestimates the risks, a culture may develop within the life insurance companies and intermediaries that allows for inadequate resources to be devoted to compliance leading to potentially significant compliance failures. Supervisors should place greater emphasis on whether the life insurance company and intermediary have an effective decision-making process. However, sample testing may be used or individual decisions reviewed as a means to test the effectiveness of the company's overall risk management (see paragraph 86). Supervisors should appreciate that even though the life insurance company and intermediaries have established appropriate risk management structures and procedures that are regularly updated, and has followed the relevant policies, procedures, and controls, the life insurance company and intermediary may still make decisions that were incorrect in light of additional information not reasonably available at the time. Supervisors and insurers are encouraged to work towards having a common understanding of the application of the risk based approach.

25. In implementing the risk-based approach, life insurance companies and intermediaries should be given the opportunity to make reasonable judgments. This will mean that no two life insurance companies and intermediaries are likely to adopt the exact same detailed practices. Such potential diversity of practice will require that regulators make greater effort to identify and disseminate guidelines on sound practice, while still allowing the potential for different approaches to meet desired risk mitigation outcomes, and may pose challenges to supervisory staff working to monitor compliance. The existence of good practice guidance, supervisory training, industry studies on prevailing AML/CFT practices and rationales and other available information and materials will assist supervisors in determining whether an insurance company has made sound risk-based judgments.

The potential benefits and potential challenges can be summarised as follows:

Potential Benefits:

- Better management of risks and cost-benefits;
- Life insurance company and intermediaries focus on real and identified threats;
- Flexibility to adapt to risks that change over time.

Potential Challenges:

- Identifying appropriate information to conduct a sound risk analysis;
- Addressing short term transitional costs;
- Greater need for more expert staff capable of making sound judgments;
- Greater need for appropriate training;
- Regulatory response to potential diversity of practice.

Chapter Three: FATF and the Risk-Based Approach

26. The varying degrees of ML/TF risk for particular types of life insurance companies and intermediaries or for particular types of customers, products or transactions is an important consideration underlying the FATF Recommendations. According to the Recommendations countries may take risk into account in two ways: (a) there is a general risk principle that applies to life insurance companies and intermediaries, and which allows countries in some cases to choose not to apply certain Recommendations either partially or fully, provided certain conditions are met; and (b) there are specific Recommendations where the degree of risk is an issue that a country either must take into account (if there is higher risk), or may take into account (if there is lower risk).

General Risk Principle

27. A country could decide that it will apply the full range of AML/CFT measures set out in Recommendations 5-11, 13-15, 18 and 21-22, to all types of financial institutions¹. However, that country may also decide to take risk into account, and may decide to limit the application of certain Recommendations provided that either of the conditions set out below are met. Where there are limitations or exemptions, this should be done on a strictly limited and justified basis:

¹ See FATF Recommendations Glossary, definition of “financial institution”.

- When a financial activity is carried out by a person or entity on an occasional or very limited basis (having regard to quantitative and absolute criteria) such that there is little risk of money laundering or terrorist financing² activity occurring, a country may decide that the application of AML/CFT measures is not necessary, either fully or partially.
- In strictly limited and justified circumstances, and based on a proven low ML risk, a country may decide not to apply some or all of the Forty Recommendations to some of the financial activities.

Specific Risk References

28. In addition to the general risk principle referred to above, the risk-based approach is either incorporated into the Recommendations (and the Methodology) in specific and limited ways in a number of Recommendations, or it is inherently part of or linked to those Recommendations. For institutions, businesses and professions covered by the FATF Recommendations, risk is addressed in four principal areas: (a) Customer Due Diligence measures (R.5-9); (b) institutions' internal control systems (R.15 & 22); (c) the approach to regulation and oversight by competent authorities (R.23); and (d) provision for countries to allow Designated Non-Financial Businesses and Professions (DNFBPs) to take the ML/TF risk into account in a similar way to financial institutions (R.12, 16 & 24).

Customer Due Diligence (R.5-9)

29. Risk is referred to in several forms:

- Higher risk – under Recommendation 5, a country must require its life insurance companies and intermediaries to perform enhanced due diligence for higher-risk customers, business relationships or transactions. Recommendation 6 (Politically Exposed Persons) is an example of this principle and is considered to be a higher risk scenario requiring enhanced CDD.
- Lower risk – a country may also permit its life insurance companies and intermediaries to take lower risk into account in deciding the extent of the CDD measures they will take (see Methodology criteria 5.9). Life insurance companies and intermediaries may thus reduce or simplify (but not avoid completely) the required measures. Two possible examples of where there may be lower ML/TF risks include life insurance companies and intermediaries that are subject to the requirements consistent with the FATF Recommendations and supervised for compliance with those requirements, and listed public companies that are subject to regulatory disclosure requirements.
- Risk arising from innovation – under Recommendation 8, a country must require its life insurance companies and intermediaries to give special attention to the risks arising from new or developing technologies that might favour anonymity.
- Risk assessment mechanism – the FATF standards expect that there will be an adequate mechanism by which competent authorities assess or review the procedures adopted by life insurance companies and intermediaries to determine the degree of risk and how they manage that risk, as well as to review the determinations made by companies. This expectation applies to all areas where the risk-based approach applies. In addition, where the competent authorities have issued guidelines to life insurance companies and intermediaries on a suitable approach to risk-based procedures, it will be important to establish that the life insurance companies and

² The reference to terrorist financing in these two statements was added in the FATF Methodology paragraph 20(a) and (b).

intermediaries have indeed followed such guidelines. The Recommendations also recognise that country risk is a necessary component of any risk assessment mechanism (R.5 & 9).

Life insurance companies and intermediaries internal control systems (R.15 & 22)

30. Under Recommendation 15, the development of “appropriate” internal policies, training and audit systems will need to include a specific and ongoing consideration of the potential ML/TF risks associated with customers, products and services, geographic areas of operation and so forth. The Interpretative Note to Recommendation 15 makes it clear that a country may allow companies to have regards to the ML/TF risks, and to the size of the business, when determining the type and extent of measures required. Similarly, country risk (and the implementation of the FATF Recommendations) must be taken into account when assessing the measures being undertaken by foreign branches and subsidiaries (R.22).

Regulation and oversight by competent authorities (R.23)

31. Under Recommendation 23, a country may have regard to the ML/TF risk in a particular life insurance company or intermediary when determining the extent of measures to license or register and appropriately regulate, and to supervise or oversee those companies for AML/CFT purposes. If there is a proven low ML/TF risk then lesser measures may be taken.

32. Recommendation 23 also recognises that life insurance companies and intermediaries should also apply elements of the IAIS Core Principles that are relevant to AML/CFT (and which are not expressly covered by the FATF Recommendations) for the purpose of combating money laundering and terrorist financing e.g. licensing of companies. Moreover, the Core Principles set out sound principles relating to the procedures for assessing and managing risk, and consideration could be given as to how those already well-defined concepts could apply to AML/CFT.

Designated Non-Financial Businesses and Professions (R.12, 16, 24)

33. In implementing AML/CFT measures for Designated Non-Financial Businesses and Professions (DNFBPs) under Recommendations 12 and 16, a country may permit DNFBPs to take money laundering and terrorist financing risk into account when determining the extent of CDD, internal controls etc, in a way similar to that permitted for financial institutions.³

34. As regards regulation and monitoring (R.24), a country may have regard to the ML/TF risk in a particular DNFBP sector (except for casinos which have been determined to be higher risk) when determining the extent of measures required to monitor or ensure compliance for AML/CFT purposes. If there is a proven low ML/TF risk then lesser monitoring measures may be taken.⁴

Other Recommendations

35. As regards the FATF Nine Special Recommendations on Terrorist Financing, SR VIII dealing with non-profit organisations also recognises that the TF risk should be taken into account,⁵ and that a targeted approach in dealing with the terrorist threat to the non-profit organisation (NPO) sector is essential given the diversity within individual national sectors and the differing degrees to which parts of each sector may be vulnerable to misuse by terrorists. Likewise the best practices document supporting SR IX

³ Handbook paragraph 42 (e) (i)

⁴ See Methodology R. 24

⁵ Handbook paragraph 42 (f).

encourages countries to base their efforts on assessed risk and threat assessments. Risk is also featured in the methodology supporting SR VII, where beneficiary financial institutions should be required to adopt effective risk-based procedures for identifying and handling wire transfers that are not accompanied by complete originator information.

36. Recommendation 25 requires adequate feedback to be provided to the financial sector and DNFBPs. Such feedback helps institutions and businesses to more accurately assess the ML/TF risks and to adjust their risk programmes accordingly. This in turn makes it more likely that better quality suspicious transaction reports will be filed. As well as being an essential input to any assessment of country or sector wide risks, the promptness and content of such feedback is relevant to implementing an effective risk-based approach.

Applicability of the risk-based approach to terrorist financing

37. The application of a risk-based approach to TF has both similarities and differences compared to ML. They both require a process for identifying and assessing risk. However, the characteristics of terrorist financing mean that the risks may be difficult to assess and the implementation strategies may be challenging due to considerations such as the relatively low value of transactions involved in terrorist financing, or the fact that funds can come from legal sources.

38. Funds that are used to finance terrorist activities may be derived either from criminal activity or may be from legal sources, and the nature of the funding sources may vary according to the type of terrorist organisation. Where funds are derived from criminal activity, then traditional monitoring mechanisms that are used to identify money laundering may also be appropriate for terrorist financing, though the activity, which may be indicative of suspicion, may not be identified as or connected to terrorist financing. It should be noted that transactions associated with the financing of terrorists may be conducted in very small amounts, which in applying a risk-based approach could be the very transactions that are frequently considered to be of minimal risk with regard to money laundering. Where funds are from legal sources then it is even more difficult to determine that they could be used for terrorist purposes. In addition, the actions of terrorists may be overt and outwardly innocent in appearance, such as the purchase of materials and services (*i.e.* commonly held chemicals, a motor vehicle, etc.) to further their goals, with the only covert fact being the intended use of such materials and services purchased. Therefore, both for terrorist funds derived from criminal activity and for legitimately sourced funds, transactions related to terrorist financing may not exhibit the same traits as conventional money laundering. However in all cases, it is not the responsibility of the insurance company or intermediary to determine the type of underlying criminal activity, or intended terrorist purpose, rather the company's role is to report the suspicious activity. The FIU and law enforcement authorities will then examine the matter further and determine if there is a link to terrorist financing.

39. Therefore, the ability of life insurance companies and intermediaries to detect and identify potential TF transactions without guidance on TF typologies or without acting on specific intelligence provided by the authorities is significantly more challenging than is the case for potential ML and other suspicious activity. Detection efforts, absent specific national guidance and typologies, are likely to be based around monitoring that focuses on transactions with countries or geographic areas where terrorists are known to operate or on the other limited typologies available (many of which are indicative of the same techniques as are used for ML).

40. Where particular individuals, organisations or countries are the subject of terrorist finance sanctions, the obligations on companies to comply and the listing of those individuals, organisations or countries as a result of such actions are determined exclusively by countries and are not a function of risk. Violations of such sanctions may result in a criminal offence or sanctions if funds or financial services are made available to a target or its agent.

41. For these reasons, this Guidance has not comprehensively addressed the application of a risk-based process to TF. It is clearly preferable that a risk-based approach be applied where reasonably practicable, but further consultation with key stakeholders is required to identify a more comprehensive set of indicators of the methods and techniques used for TF, which can then be factored into strategies to assess TF risks and devise measures to mitigate them. Life insurance companies and intermediaries would then have an additional basis upon which to more fully develop and implement a risk-based process for TF.

Limitations to the risk-based approach

42. There are circumstances in which the application of a risk-based approach will not apply, or may be limited. There are also circumstances in which the application of a risk-based approach may not apply to the initial stages of a requirement or process, but then will apply to subsequent stages. The limitations to the risk-based approach are usually the result of legal or regulatory requirements that mandate certain actions to be taken.

43. Requirements to freeze the assets of identified individuals or entities, in jurisdictions where such requirements exist, are independent of any risk assessment. The requirement to freeze is absolute and cannot be impacted by a risk-based process. Similarly, while the identification of potential suspicious transactions can be advanced by a risk-based approach, the reporting of suspicious transactions, once identified, is not risk-based.

44. There are a number of components to CDD – identification and verification of identity of customers and beneficial owners, obtaining information on the purposes and intended nature of the business relationships and conducting ongoing due diligence. Of these components, the identification and verification of identity of customers are requirements which must be completed regardless of the risk-based approach. However, in relation to all the CDD components, a reasonably implemented risk-based approach may allow for a determination of the extent and quantity of information required, and the mechanisms to be used to meet these minimum standards. Once this determination is made, the obligation to keep records and documents that have been obtained for due diligence purposes, as well as transaction records, is not dependent on risk levels.

45. Countries may allow life insurance companies and intermediaries to apply reduced or simplified measures where the ML/TF risk is lower. However, these reduced or simplified measures do not necessarily apply to all aspects of CDD. Moreover, where these reduced or simplified measures are subject to certain conditions being met, it is necessary to verify that these conditions apply, and where the exemption applies under a certain threshold, measures should be in place to prevent transactions from being split artificially to avoid the threshold. In addition, information beyond customer identity, such as customer location and account purpose, may be needed to adequately assess risk. This will be an iterative process: the preliminary information obtained about a customer should be sufficient to determine whether to go further, and in many cases customer monitoring will provide additional information.

46. Some form of transaction monitoring, whether it is automated, manual, a review of exception reports or a combination of acceptable options, depending on the risks presented, is required in order to detect unusual and hence possibly suspicious transactions. The method of monitoring, whether at the transaction level, the policy/account/contract level, or at the customer level, should fall within the purview of the life insurance company or intermediary, and should be based on the risk present. This individual or aggregate risk may change over time, and the methods of monitoring should be flexible enough to adjust to this change even in the case of lower risk customers, monitoring is needed to verify that transactions match the initial low risk profile and if not, trigger a process for appropriately revising the customer's risk rating. Equally, risks for some customers may only become evident once the customer has begun transacting either through an account or otherwise in the relationship with the insurance company or intermediary. This makes appropriate and reasonable monitoring of customer transactions an essential component of a

properly designed risk-based approach, however within this context it should be understood that not all transactions, accounts or customers will be monitored in exactly the same way. Moreover, where there is an actual suspicion of money laundering or terrorist financing, this could be regarded as a higher risk scenario, and enhanced due diligence should be applied regardless of any threshold or exemption.

Distinguishing Risk-Based Supervision and Risk-Based Policies and Processes

47. Risk-based policies and processes in life insurance companies and intermediaries should be distinguished from risk-based supervision. As illustrated through the 2003 IAIS Core Principles and Methodology there is a general recognition within supervisory practice of allocating resources taking into account the risks posed by individual life insurance companies or intermediaries. The methodology adopted by regulatory authorities to determine allocation of supervisory resources should cover the business focus, the risk profile and the internal control environment, and should permit relevant comparisons between life insurance companies or intermediaries. The methodology used for determining the allocation of resources will need updating on an ongoing basis so as to reflect the nature, importance and scope of the risks to which individual life insurance companies or intermediaries are exposed. Consequently, this prioritisation would lead supervisors to demonstrate increased regulatory attention to life insurance companies and intermediaries that engage in activities assessed to be of higher ML/TF risks.

48. However, it should also be noted that the risk factors taken into account to prioritise the supervisors' work will depend not only on the intrinsic risk associated with the activity undertaken, but also on the quality and effectiveness of the risk management systems put in place to address such risks.

49. Since prudential regulators should have already assessed the quality of risk management controls throughout life insurance companies and intermediaries, it is reasonable that their assessments of these controls be used, at least in part, to inform ML/TF risk assessments (see also paragraph 1.26 above).

Summary box: A risk-based approach to countering money laundering and terrorist financing at the national level: key elements for success

- Life insurance companies and intermediaries and regulators should have access to reliable and actionable information about the threats.
- There must be emphasis on cooperative arrangements among the policy makers, law enforcement, regulators, and the private sector.
- Authorities should publicly recognize that the risk-based approach will not eradicate all elements of risk.
- Authorities have a responsibility to establish an atmosphere in which life insurance companies and intermediaries need not be afraid of regulatory sanctions where they have acted responsibly and implemented adequate internal systems and controls.
- Regulators' supervisory staff must be well-trained in the risk-based approach, both as applied by supervisors and by life insurance companies and intermediaries.
- Requirements and supervisory oversight at the national level should be consistent among similar industries.

SECTION TWO:
GUIDANCE FOR PUBLIC AUTHORITIES

Chapter One: High-level principles for creating a risk-based approach

50. The creation of a risk-based approach to countering money laundering and the financing of terrorism will allow competent authorities and life insurance companies and intermediaries to use their resources most effectively. This chapter sets out five high-level principles that should be considered by countries when designing a risk-based approach. They could be considered as setting out a broad framework of good practice.

51. The five principles set out in this chapter are intended to assist countries in their efforts to improve their AML/CFT regimes. They are not intended to be prescriptive, and should be applied in a manner that is well-considered and is appropriate to the particular circumstances of the country in question.

Principle One: Understanding and responding to the threats and vulnerabilities: a national risk assessment

52. Successful implementation of a risk-based approach to combating ML/TF depends on a sound understanding of the threats and vulnerabilities. Where a country is seeking to introduce a risk-based approach at a national level, this will be greatly aided if there is a national understanding of the risks facing the country. This understanding can flow from a national risk assessment.

53. National risk assessments should be tailored to the circumstances of each country. For a variety of reasons, including the structure of competent authorities and the nature of the financial services sector, each country's judgements about the risks will be unique, as will their decisions about how to implement a national assessment in practice. A national assessment need not be a single formal document. It should be considered as a process that is designed to achieve a specific outcome. The desired outcome is that decisions about allocating responsibilities and resources at the national level are based on a comprehensive and up-to-date understanding of the risks. Competent authorities, in consultation with the private sector, should consider how best to achieve this while also taking into account any risk associated with providing information on vulnerabilities in their financial systems to money launderers, terrorist financiers, and other criminals.

Principle Two: A legal/regulatory framework that supports the application of a risk-based approach

54. Countries should consider whether their legislative and regulatory frameworks are conducive to the application of the risk-based approach. Where appropriate the obligations imposed on life insurance companies and intermediaries should be informed by the outcomes of the national risk assessment.

55. The risk-based approach does not mean the absence of a clear statement of what is required from life insurance companies and intermediaries. However under a risk-based approach, life insurance companies and intermediaries should have a degree of flexibility to implement policies and procedures

which respond appropriately to their own risk assessment. In effect, the standards implemented may be tailored and/or amended by additional measures as appropriate to the risks of a particular insurance company/business. The fact that policies and procedures, in accordance to the risk levels, may be applied flexibly to different products, services, customers and locations does not mean that policies and procedures need not be clearly defined.

56. Basic minimum AML/CFT requirements can coexist with a risk-based approach. Indeed, sensible minimum standards, coupled with scope for these to be enhanced when the risk justifies it, should be at the core of risk-based AML/CFT requirements. These standards should, however, be focused on the outcome (combating through deterrence, detection, and reporting of ML/TF), rather than applying legal and regulatory requirements in a purely mechanistic manner to every customer.

Principle Three: Design of a supervisory framework to support the application of the risk-based approach

57. Where competent authorities have been assigned responsibility for overseeing life insurance companies and intermediaries AML/CFT controls, countries may wish to consider whether such authorities are given the necessary authority to implement a risk-based approach to supervision. Barriers to this may include inappropriate reliance on detailed and prescriptive requirements in the regulator's rules. These requirements may, in turn, stem from the laws under which the regulator gained its powers.

58. Where appropriate, regulators should seek to adopt a risk-based approach to the supervision of life insurance companies and intermediaries' controls to combat ML/TF. This should be based on a thorough and comprehensive understanding of the types of activity the life insurance companies and intermediaries undertake and the ML/TF risks to which these are exposed. Regulators will probably need to prioritise resources based on their overall assessment of where the risks are, and which companies are most exposed to them.

59. Regulators with responsibilities other than those related to AML/CFT will need to consider these risks alongside other risk assessments arising from the regulator's wider duties.

60. Such risk assessments should help the regulator choose where to apply resources in its supervisory programme, with a view to using limited resources to achieve the greatest effect. A risk assessment may also identify that the regulator does not have adequate resources to deal with the risks⁶. In such circumstances the regulator may need to obtain additional resources or adopt other strategies to manage or mitigate any unacceptable residual risks.

61. The application of a risk-based approach to supervision requires that regulators' staff be able to make principle-based decisions in a similar fashion as would be expected from the staff of an insurance company or intermediary that has adopted a risk-based approach. These decisions will cover the adequacy of the insurance company or intermediary's arrangements to combat ML/TF. As such, a regulator may wish to consider how best to train its staff in the practical application of a risk-based approach to supervision. Supervisory staff will need to be well-briefed as to the general principles of a risk-based approach, its possible methods of application, and what a risk-based approach looks like when successfully applied by a life insurance company or intermediary.

⁶ See FATF Recommendation 30.

Principle Four: Identifying the stakeholders and ensuring consistency

62. Countries should consider who the main stakeholders are when adopting a risk-based approach to combating ML/TF. These will differ between countries. Thought should be given as to the most effective way to share responsibility between these parties, and how information may be shared to best effect. For example, which body or bodies are best placed to provide guidance to the financial services industry about how to implement an AML/CFT risk-based approach.

63. A list of potential stakeholders may be considered to include the following:

- Government – this may include legislature, executive, and judiciary.
- Law enforcement agencies - this might include the police, customs etc.
- The financial intelligence unit (FIU), security services, other similar agencies etc.
- Regulators.
- The private sector – this might include financial services firms, professional services firms (such as accountants and lawyers), professional organisations (such as insurance professional organisations), etc.
- The public – arrangements designed to counter money laundering and terrorist financing are ultimately designed to protect the law-abiding public. However these arrangements may also act to place burdens on customers of financial services firms.
- Others – those who are in a position to contribute to the conceptual basis underpinning the risk-based approach. Such stakeholders may include academia and the media.

64. Clearly a government will be able to exert influence more effectively over some of these stakeholders than others. However, a government will be in a position to assess how all stakeholders can be encouraged to support efforts to combat ML/TF.

65. A further element is the role that governments have in seeking to gain recognition of the relevance of a risk-based approach from competent authorities. This may be assisted by relevant authorities making clear and consistent statements about the risk-based approach on the following:

- Life insurance companies and intermediaries can be expected to have flexibility to adjust their internal systems and controls taking into consideration lower and high risks, so long as such systems and controls are reasonable. However, there are also minimum legal and regulatory requirements and elements that apply irrespective of the risk level, for example suspicious transaction reporting and minimum standards of customer due diligence.
- Acknowledging that a life insurance company or intermediary's ability to detect and deter ML/TF can sometimes be necessarily limited and that information on risk factors is not always robust or freely available. There should therefore be reasonable policy and supervisory expectations about what a life insurance company or intermediary with good controls aimed at preventing ML/TF is able to achieve. A life insurance company or intermediary may have acted in good faith to take reasonable and considered steps to prevent ML/TF, and documented the rationale for its decisions, and yet still be abused by a criminal.

- Acknowledging that not all high risk situations will be identical and as a result will not always require precisely the same type of enhanced due diligence.

Principle Five: Information exchange between the public and private sector

66. Effective information exchange between the public and private sector will form an integral part of a country's strategy for combating ML/TF. In many cases, it will allow the private sector to provide competent authorities with information they identify as a result of previously provided government intelligence.

67. Public authorities, whether law enforcement agencies, regulators or other bodies, have privileged access to information that may assist life insurance companies or intermediaries to reach informed judgments when pursuing a risk-based approach to counter money laundering and terrorist financing. Likewise, life insurance companies and intermediaries are able to understand their clients' businesses reasonably well. It is desirable that public and private bodies work collaboratively to identify what information is valuable to help combat money laundering and terrorist financing, and to develop means by which this information might be shared in a timely and effective manner.

68. To be productive, information exchange between the public and private sector should be accompanied by appropriate exchanges among public authorities. FIUs, supervisors and law enforcement agencies should be able to share information and feedback on results and identified vulnerabilities, so that consistent and meaningful inputs can be provided to the private sector. All parties should of course, consider what safeguards are needed to adequately protect sensitive information held by public bodies from being disseminated too widely. The goal of the dialogue should be to provide all parties with the maximum amount of information needed to create and maintain risk mitigation strategies and to place life insurance companies and intermediaries in a position to make informed judgments.

69. Relevant stakeholders should seek to maintain a dialogue so that it is well understood what information has proved useful in combating money laundering and terrorist financing ⁷ For example the types of information that might be usefully shared between the public and private sector would include, if available:

- Assessments of country or geographic area risk.
- Typologies or assessments of how money launderers and terrorists have abused the financial system, in particular in the life insurance sector.
- Feedback on suspicious transaction reports and other relevant reports.
- Targeted unclassified intelligence. In specific circumstances, and subject to appropriate safeguards, it may also be appropriate for authorities to share targeted confidential information with life insurance companies and intermediaries.
- Countries, persons or organisations whose assets or transactions should be frozen.

70. When choosing what information can be properly and profitably shared, public authorities may wish to emphasize to the life insurance sector that information from public bodies should inform, but not be a substitute for a life insurance company or intermediary's own judgments. For example, countries may decide to not create what are perceived to be definitive lists of low risk customer types. Instead public

⁷ Examples of such dialogue are included in section one of these guidelines.

authorities may prefer to share information on the basis that this will be one input into an insurance company or intermediary's decision making processes, along with any other relevant information that is available to the life insurance company or intermediary.

Chapter Two: Implementation of the Risk-Based Approach

Assessment of Risk to Inform National Priorities:

71. A risk-based approach should be built on sound foundations: efforts must first be made to ensure that the risks are well understood. As such, a risk-based approach should be based on an assessment of the threats. This is true whenever a risk-based approach is applied, at any scale, whether by countries or individual life insurance companies and intermediaries. A country's approach should be informed by its efforts to develop an understanding of the risks in that country. This can be considered as a "national risk assessment".

72. A national risk assessment should be regarded as a description of fundamental background information to assist supervisors, law enforcement authorities, and the FIU to ensure that decisions about allocating responsibilities and resources at the national level are based on a practical, comprehensive and up-to-date understanding of the risks.

73. A national risk assessment should be tailored to the circumstances of the individual country, both in how it is executed, and its conclusions. Factors that may influence the ML/TF risk in a country could include the following:

- Political environment.
- Legal environment.
- A country's economic structure.
- Cultural factors and the nature of civil society.
- Sources, location and concentration of criminal activity.
- Size of the insurance industry.
- Composition of the insurance industry.
- Ownership structure of life insurance companies and intermediaries.
- Corporate governance arrangements in life insurance companies and intermediaries and the wider economy.
- The nature of payment systems and the prevalence of cash-based transactions.
- Geographical spread of insurance industry's operations and customers.
- Types of products and services offered by the insurance industry.
- Types of customers serviced by the insurance industry.

- Types of most frequently occurring predicate offences.
- Amounts of illicit money generated domestically.
- Amounts of illicit money generated abroad and laundered domestically.
- Main channels or instruments used for ML/TF.
- Sectors of the legal economy affected.
- Underground areas in the economy.

74. Countries should also consider how an understanding of the ML/TF risks can be best achieved at the national level. Which body or bodies will be responsible for contributing to this assessment? How formal should an assessment be? Should the competent authority's view be made public? These are all questions for the competent authority to consider.

75. The desired outcome is that decisions about allocating responsibilities and resources at the national level are based on a comprehensive and up-to-date understanding of the risks. To achieve the desired outcome, competent authorities should develop and implement measures to mitigate the identified risks.

76. Developing and operating a risk-based approach involves forming judgements. It is important that these judgements are well informed. It follows that, to be effective, the risk-based approach should be information-based and include intelligence where appropriate. Effort should be made to ensure that risk assessments are based on fresh and accurate information. Countries, in partnership with law enforcement bodies, FIUs, and regulators, are well placed to bring their knowledge and expertise to bear in developing a risk-based approach that is appropriate for their particular country. Their assessments will not be static: they will change over time, depending on how circumstances develop and how the threats evolve. As such, countries should facilitate the flow of information between different bodies, so that there are no institutional impediments to information dissemination.

77. Whatever form it takes, a national assessment of the risks, along with measures to mitigate those risks, can inform how resources are applied to combat money laundering and terrorist financing, taking into account other relevant country policy goals. It can also inform how these resources are most effectively assigned to different public bodies, and how those bodies make use of their resources in an effective manner.

78. As well as assisting competent authorities to decide how to allocate public funds to combat money laundering and terrorist financing, a national risk assessment can also inform decision-makers about the relationship between the supervisory/regulatory regime and the identified risks. An over-zealous effort to counter the risks could be damaging and counter-productive, placing unreasonable burdens on industry, and act against the interests of the public by limiting access to services for some segments of the population. Alternatively, efforts may not be sufficient to provide protection to societies from the threats posed by criminals and terrorists. A sound understanding of the risks at the national level could help obviate these dangers.

Regulatory Supervision – General Principles

Defining the acceptable level of risk

79. The level of AML/CFT risk will generally be affected by both internal and external risk factors. For example, risk levels may be increased by internal risk factors such as weak compliance resources, inadequate risk controls and insufficient senior management involvement. External level risks may rise due to factors such as the action of third parties and/or political and public factors.

80. As described in Section One, all financial activity involves an element of risk. Competent authorities should not prohibit life insurance companies and intermediaries from conducting business with high risk customers as long as appropriate policies, procedures and processes to manage the attendant risks are in place. Only in specific cases, for example when justified by the fight against terrorism, crime or the implementation of international obligations, are designated individuals, legal entities, organisations or countries categorically denied access to services.

81. However, this does not exclude the need to implement basic minimum requirements. For instance FATF Recommendation 5 states that “Where the financial institution is unable to comply with paragraphs (a) – (c) [“the CDD requirements”], it should not open the account, commence business relations or perform the transaction; or should terminate the business relationship; and should consider making a suspicious transaction report in relation to the customer.” So the level of risk should strike an appropriate balance between the extremes of not accepting customers, and conducting business with unacceptable or unmitigated risk.

82. Competent authorities expect life insurance companies and intermediaries to put in place effective policies, programmes, procedures, controls and systems to mitigate the risk and acknowledge that even with effective systems not every suspect transaction will necessarily be detected. They should also ensure that those policies, programmes, procedures, controls and systems are applied effectively to prevent life insurance companies and intermediaries from becoming conduits for illegal proceeds and ensure that they keep records and make reports that are of use to national authorities in combating money laundering and terrorist financing. Efficient policies and procedures will reduce the level of risks, but are unlikely to eliminate them completely. Assessing ML/TF risks requires judgement and is not an exact science. Monitoring aims at detecting unusual or suspicious transactions among an extremely large number of legitimate transactions. Furthermore the demarcation of what is unusual may not always be straightforward since what is “customary” may vary depending on the customers’ business. This is why developing an accurate customer profile is important in managing a risk-based system. Moreover, procedures and controls are frequently based on previous typologies cases, but criminals will adapt their techniques.

83. Additionally, not all high risk situations are identical, and therefore will not always require precisely the same level of enhanced due diligence. As a result, supervisors will expect life insurance companies and intermediaries to identify individual high risk categories and apply specific and appropriate mitigation measures. For example, some categories could be:

- Non-resident customers (to understand why they want to open an account in a different country).
- Politically Exposed Persons (to apply a specific policy); and
- Companies with bearer shares (to exert particular vigilance on the identification and verification of the beneficial owner).

84. Further information on the identification of specific risk categories is provided in Section Three, “Guidance for the Private Sector”.

Proportionate Supervisory Actions to support the Risk-Based Approach

85. Supervisors should seek to identify weaknesses through an effective programme of both on-site and off-site supervision, and through analysis of internal and other available information.

86. In the course of their examinations, supervisors should review an insurance company or intermediary's AML/CFT risk assessments, as well as its policies, procedures and control systems to arrive at an overall assessment of the risk profile of the company and the adequacy of its mitigation measures. Where available, assessments carried out by or for the company or intermediary may be a useful source of information. The assessment should include sample transaction testing of customer accounts to validate the assessment. The supervisor's assessment of management's ability and willingness to take necessary corrective action is also a critical determining factor. Supervisors should use proportionate actions to ensure proper and timely correction of deficiencies, taking into account that identified weaknesses can have wider consequences. Generally, systemic breakdowns or inadequate controls will result in the most severe supervisory response.

87. Nevertheless, it may happen that the lack of detection of an isolated high risk transaction, or of transactions of an isolated high risk customer, will in itself be significant, for instance where the amounts are significant, or where the ML/TF typology is well known, or where such a scheme has remained undetected for a long time. Such a case might indicate an accumulation of weak risk management practices or regulatory breaches regarding the identification of high risks, transaction monitoring, staff training and internal controls, and therefore, might alone justify supervisory action.

88. Supervisors should be in a position to compare risk factors and procedures used by peer life insurance companies and intermediaries. This will, among other objectives, assist the supervisors in better understanding how life insurance companies and intermediaries are developing and implementing a risk-based approach, as well as in identifying potential deficiencies. Similarly, supervisors can and should use their knowledge of the risks associated with products, services, customers and geographic locations to help them evaluate life insurance companies and intermediaries ML/TF risk assessment, with the understanding, however, that they may possess information that has not been made available to life insurance companies and intermediaries and, therefore, life insurance companies and intermediaries would not have been able to take such information into account when developing and implementing a risk-based approach. Supervisors (and other relevant stakeholders) are encouraged to use that knowledge to issue guidelines to assist life insurance companies and intermediaries in managing their risks. Where life insurance companies and intermediaries are permitted to determine the extent of the CDD measures on a risk sensitive basis, this should be consistent with guidelines issued by the competent authorities⁸. An assessment of the risk-based approach will, for instance, help identify cases where companies use excessively narrow risk categories that do not capture all existing risks, or adopt criteria that lead to the identification of a large number of higher risk relationships, but without providing for adequate additional due diligence measures.

89. In the context of the risk-based approach, the primary focus for supervisors should be to determine whether or not the insurance company or intermediary's AML/CFT compliance and risk management programme is adequate to: (a) meet the minimum regulatory requirements, and (b) appropriately and effectively mitigate the risks. The supervisory goal is not to prohibit high risk activity, but rather to be confident that life insurance companies and intermediaries have adequately and effectively implemented appropriate risk mitigation strategies.

90. Under FATF Recommendation 29, supervisors should impose adequate sanctions for failure to comply with statutory and regulatory requirements to combat ML/TF, and effective AML/CFT supervision

⁸ FATF Recommendations 5 & 25, Methodology Essential Criteria 25.1 and 5.12.

requires that the supervisor has available an appropriate range of supervisory tools for use when, in the supervisor's judgement, a company or an intermediary is not complying with laws, regulations or supervisory decision. These tools include the ability to require a life insurance company or intermediary to take prompt remedial action and to impose penalties⁹. In practice, the range of tools available should be applied in accordance with the gravity of a situation.

91. Fines and/or penalties may not be necessary in all regulatory actions to correct or remedy AML/CFT deficiencies. However, supervisors must have the authority and willingness to apply fines and/or penalties in cases where substantial deficiencies exist. More often than not, action should take the form of a remedial program through the normal supervisory processes.

92. A number of generic aspects of proportionate supervisory actions have been set out in the International Association of Insurance Supervisors (IAIS) Core Principles and Methodology (October 2003). The key concepts drawn from these principles concerning the fight against money-laundering and terrorist financing are outlined in Appendix One.

93. In considering the above factors it is clear that proportionate regulation will be supported by two central features:

a) Regulatory Transparency

94. In the implementation of proportionate actions, regulatory transparency will be of paramount importance. Supervisors are aware that life insurance companies and intermediaries, while looking for operational freedom to make their own risk judgements, will also seek guidance on regulatory obligations. As such, the regulator with AML/CFT supervisory responsibilities should seek to be transparent in setting out what it expects from regulated companies, and will need to consider appropriate mechanisms of communicating these messages. For instance, this may be in the form of high-level requirements, based on desired outcomes, rather than detailed process.

95. No matter what individual procedure is adopted, the guiding principle will be that life insurance companies and intermediaries are aware of their legal responsibilities and regulatory expectations. In the absence of this transparency there is the danger that supervisory actions may be perceived as either disproportionate or unpredictable which may undermine even the most effective application of the risk-based approach by life insurance companies and intermediaries.

b) Staff Training of Supervisors and Enforcement Staff

96. In the context of the risk-based approach, it is not possible to specify precisely what a life insurance company or intermediary has to do, in all cases, to meet its regulatory obligations. Thus, a prevailing consideration will be how best to ensure the consistent implementation of predictable and proportionate supervisory actions. The effectiveness of supervisory training will therefore be important to the successful delivery of proportionate supervisory actions.

97. Training should aim to allow supervisory staff to form sound comparative judgements about life insurance companies and intermediaries AML/CFT systems and controls. It is important in conducting assessments that supervisors have the ability to make judgements regarding management controls in light of the risks assumed by companies and considering available and widely known industry practices. Supervisors might also find it useful to undertake comparative assessments so as to form judgements as to the relative strengths and weaknesses of different companies' arrangements.

⁹ See IAIS Core Principles and Methodology – ICP15 (October 2003)

98. The training for supervisors should include evaluation of senior management capacity to implement adequate risk management measures, and the necessary procedures and controls. The training should also include reference to specific guidance, where available. It should be noted that “the supervisory process should include not only a review of policies and procedures, but also a review of customer files and the sampling of some accounts”¹⁰. The supervisor has equally to assess whether or not the processes are adequate, and if it “determines that the risk management processes are inadequate, it has the power to require a life insurance company or intermediary to strengthen them”¹¹. Supervisors also should be satisfied that sufficient resources are in place to ensure the implementation of effective risk management.

99. To fulfil these responsibilities, training should enable supervisory staff to adequately assess:

- The quality of internal procedures, including ongoing employee training programmes and internal audit, compliance and risk management functions.
- Whether or not the risk management policies and processes are appropriate in light of the insurance company or intermediary’s risk profile, and are periodically adjusted in light of changing risk profiles.
- The participation of senior management to confirm that they have undertaken adequate risk management, and that the necessary procedures and controls are in place.

Whilst by no means an exhaustive list, onsite examination topics may include the following:

- The application of a group-wide policy
- Assessment of the risk associated with each business line
- The extent that assessments have been formally documented and segmented by products, delivery channels, types of customer and geographic location of customers
- Extent of CDD procedures including identification of new customers, customer profiling and collection of 'Know Your Customer' information
- Additional due diligence is undertaken in relation to high risk customers and businesses, e.g. Politically Exposed Persons
- Transaction monitoring procedures in place and how alerts are reviewed
- Policies determining how and on what basis existing customer files may be updated
- Quality of internal systems and controls, including processes for identifying and reporting large cash and suspicious transactions
- Policies on record keeping and ease of retrieving identification evidence or transaction records
- Scope, frequency and audience of AML/CFT training and evaluation of effectiveness
- Appropriate sample testing
- Quality and sufficiency of reporting to senior management and the Board to determine adequacy and effectiveness

There is no set of 'right answers' to these topics. The key considerations are that (a) the insurance company is meeting any minimum regulatory requirements (b) the insurance company has identified its money laundering and terrorist financing risks, worked out how best to manage those risks, and devoted adequate resources to the task; and (c) senior management is properly accountable for AML/CFT controls.

¹⁰ See R.29 and *Customer due diligence for banks*, § 61.

¹¹ IAIS Core Principles and Methodology, ICP10.

SECTION THREE:

GUIDANCE FOR LIFE INSURANCE COMPANIES AND INTERMEDIARIES ON IMPLEMENTING A RISK-BASED ANTI-MONEY LAUNDERING PROGRAM

Preamble

100. Implementing a risk-based approach establishes criteria against which a life insurance company or intermediary's customers, products, distribution channels and geographical locations can be assessed with respect to the degree of risk they pose the company as a target of money laundering or as a vehicle for terrorist financing.

101. Life insurance companies provide insurance products to customers through a number of different distribution channels, many of which involve intermediaries. Intermediaries play an important service role in the introduction and placement of life insurance and other investment related insurance products with insurance companies and such a role has implications for the risk-based approach to combating ML/TF (See Annex 2). Within this framework, customers' occupation and source of funds, the frequency and type of customer transactions, the geographic location of customers and intermediaries, the degree to which intermediaries are regulated for AML/CFT, and governmental and international organizations sanctions and guidance may be considered in determining the degree of risk, identifying mitigating controls, and allocating resources to the highest risk customers, products, and countries.

102. Money laundering is an activity in which the participants seek to conceal its criminal nature in order to evade detection. In the absence of insider information known only to the criminals themselves, the analysis of money laundering risks is based on professional experience formed from information derived from cases that have become publicly known as well as vulnerabilities identified by life insurers that may not be publicly known. As a result, client profiles based on false or misleading information given by customers with criminal intentions may only be of limited or no practical use. The purpose of preventive measures is to reduce and minimize the extent to which false or misleading information can be effectively used to hide illicit activity.

103. Characteristics of terrorist financing present differently from money laundering and, therefore, the associated risk may be difficult to assess without a more comprehensive set of indicators of the methods and techniques used for terrorist financing (see paragraphs 37 to 41). However, a reasonably designed risk-based approach to money laundering, as well as an insurer's anti-fraud activities, can assist in providing a means by which potential terrorist financing risks can be assessed (at least partially).

104. Although its vulnerability is not regarded by the IAIS to be as high as for other sectors of the financial industry the insurance sector is a possible target for money launderers and terrorist financing.¹² Life insurance companies and intermediaries should therefore work with regulators and law enforcement to take adequate measures to mitigate and manage potential risks.

¹² See, International Association of Insurance Supervisors, *Guidance Paper on Anti-Money Laundering and Combating the Financing of Terrorism*, October 2004, p. 1

105. Products offered by life insurance companies are primarily aimed at transferring the financial risk of a certain event - such as premature death or outliving savings in retirement - from the insured to the insurer. Customers buy life insurance contracts for which they remit stated payments and are guaranteed a minimum payment as designated at death or some other specified time.

106. A customer may be an individual, a legal person, or a legal arrangement, and there could also be beneficial owners involved. The beneficiary of the contract may be the customer or it may be a third party to the relationship between the insurer and the customer. Further issues may arise from factors such as (but not limited to) the assignment of the legal right to the benefit of the contract, the provision of a “cooling off” period and cross border elements to the relationship.

107. Ultimately, effective prevention of money laundering and terrorist financing depends on close cooperation among regulators, law enforcement, and life insurance companies, and a risk-based approach establishes a joint framework that facilitates useful feedback and a partnership among these stakeholders. For life insurance companies and intermediaries, this means a commitment to develop and implement reasonable, risk-based policies, procedures and controls which address the risks of financial crime posed by their products, customers, distribution channels and geographical locations and assist in the reporting of suspicious activity and other relevant information to the competent authority. Regulators and law enforcement should be willing and able to share information with the industry so that they may develop programs that address the risks known to the government.

Chapter One: Risk Categories

108. In order to implement a reasonable risk-based approach, life insurance companies and intermediaries should identify appropriate criteria for categorizing risks and assessing risks in each category. Identification of the ML/TF risks posed by customers, categories of customers, beneficial owners, beneficiaries, products, distribution channels and geographies together with an assessment of the level of the risk, will allow life insurance companies and intermediaries to determine and implement appropriate policies, procedures and controls to mitigate these risks. While a risk assessment should always be undertaken at the inception of a customer relationship, for some customers, a comprehensive risk profile may only become evident over time. A life insurance company or intermediary may also have to adjust its view of a particular customer, distribution channels, geography or product based upon information received from a competent authority.

109. While there is no universal set of risk categories, the examples provided herein are the most commonly identified risk categories. There is no one single methodology to apply to assessing the risk in these categories, and the application of these risk categories is intended to provide a broad strategy for managing the potential risks.

Country/Geographic Risk

110. Country risk, in conjunction with other risk factors, provides useful information when assessing ML and TF risks. Factors that may result in a determination that a country poses a higher risk include:

- Countries identified by FATF Statements as having weak AML/CFT regimes, and for which financial institutions should give special attention to business relationships and transactions.
- Countries or geographic areas subject to sanctions, embargoes, or statements of concern issued by international bodies such as the United Nations (“UN”), FATF, or governments. In addition, in some circumstances, countries subject to sanctions or measures similar to those issued by bodies such as the UN, but which may not be universally recognized, may be given credence by

an life insurance company or intermediary because of the standing of the issuing body and the nature of the measures.

- Countries or geographic areas identified by credible sources¹³ as lacking appropriate AML/CFT laws, regulations and other measures.
- Countries or geographic areas identified by credible sources as providing funding or support for terrorist activities or that have designated terrorist organisations operating within them.
- Countries or geographic areas identified by credible sources as having significant levels of corruption, or other criminal activity.
- Countries or geographic areas where protection for customers' privacy prevents the effective implementation of AML/CFT requirements and/or facilitates the framework for the establishment of shell-companies or the issuance of bearer shares.
- Cross border elements such as the insurer, the customer and the beneficiary of the contract being in separate jurisdictions.

111. Life insurance companies and intermediaries should take into account warnings issued by competent authorities about risks applicable to countries or geographic areas, including the specificity as to the particular risks posed.

Customer Risk

112. Determining the potential ML/TF risks posed by a customer or category of customers is critical to the development of an overall risk framework. Based on its own criteria and consistent with applicable law, an insurance company or intermediary should determine whether a particular customer or category of customer poses a higher risk. Application of risk variables may mitigate or exacerbate the risk assessment. Categories of customers whose activities may indicate a higher risk include:

- Customers conducting their business relationship or transactions in unusual circumstances, such as:
 - Significant and unexplained geographic distance between residence or business location of the customer and the location where the product sale took place (or the location of the insurer's representative).
 - Frequent and unexplained movement of accounts/policies/contracts/funds to different insurance companies or other financial institutions.
 - Frequent and unexplained movement of funds between financial institutions in various geographic locations.

¹³ "Credible sources" refers to information that is produced by well-known bodies that generally are regarded as reputable and that make such information publicly and widely available. In addition to the Financial Action Task Force and FATF-style regional bodies, such sources may include, but are not limited to, supra-national or international bodies such as the International Monetary Fund, the World Bank and the Egmont Group of Financial Intelligence Units, as well as relevant national government bodies and non-governmental organisations.

- Customers that are legal persons whose structure makes it difficult to identify the ultimate beneficial owner or controlling interests.
- Customers who seek or accept very unfavourable account/policy/contract provisions or riders.
- Customers who rely on “free look” provisions in unusual circumstances¹⁴.
- Charities and other “not for profit” organisations which are not subject to monitoring or supervision (especially those operating on a “cross-border” basis)¹⁵.
- "Gatekeepers" such as accountants, lawyers, or other professionals holding accounts/policies/contracts at an insurance company, acting on behalf of their clients, and where the insurance company places unreasonable reliance on the gatekeeper.
- Customers who are Politically Exposed Persons (PEPs).
- Customers where the beneficial owner of the contract is not known (*e.g.* certain trusts).
- Customers who are introduced through non face-to-face channels.
- Customers who use unusual payment methods, such as cash, cash equivalents (when such a usage of cash or cash equivalents is, in fact, unusual), or structured monetary instruments.
- Customers who seek early termination of a product (including during the "free look" period), especially at a cost to the customer, or where payment is made by, or the refund check is directed to, an apparently unrelated third party.
- Customers who transfer the benefit of a product to an apparently unrelated third party.
- Customers who show little concern for the investment performance of a product, but a great deal of concern about the early termination features of the product.
- Customers who are reluctant to provide identifying information when purchasing a product, or who provides minimal or seemingly fictitious information.

113. Similar issues, criteria or circumstances may be relevant to the ML/FT risk associated with the beneficiary(ies) of the life insurance contract.

¹⁴ A “free look” provision is a contractual provision, often mandatory under local law, which allows a policy owner or annuitant of a life insurance or annuity contract to examine a contract for a certain number of days and return it for a full refund.

¹⁵ See Special Recommendation VIII.

Product/Service/Transaction Risk

114. An overall risk assessment should also include determining the potential risks presented by different products and services offered by an insurance company. Life insurance companies should be mindful of the risk associated with certain products or services not specifically being offered by life insurance companies, but that make use of the company's services to deliver the product. The following features may tend to increase the risk profile of a product:

- Acceptance of payments or receipts from third parties.
- Acceptance of very high value or unlimited value payments or large volumes of lower value payments.
- Acceptance of payments made in cash or endorsed money orders or cashier cheques.
- Acceptance of frequent payments outside of a normal premium policy or payment schedule.
- Allowance of withdrawals at any time with limited charges or fees.
- Acceptance to be used as collateral for a loan and/or written in a discretionary or other increased risk trust.
- Products that allow for high cash values.
- Products that accept high amount lump sum payments, coupled with liquidity features.
- Products with "free look" provisions, in particular when they are relied upon in unusual circumstances (*e.g.*, no credible reason for reliance is present or a request is made to send the refunded monies to an unrelated third party, a foreign financial institution, or to an entity located in a high risk country).
- Products that allow for assignment without the insurer being aware that the beneficiary of the contract has been changed until such time as a claim is made.

Variables That May Impact Risk

115. A life insurance company or intermediary's risk-based approach methodology should take into account risk variables specific to a particular customer or transaction. These variables, either singly or in combination, may increase or decrease the perceived risk posed by a particular customer, product, distribution channels, geographic location or transaction and may include:

- Public information available on a customer.
- A combination of higher risk factors within the client relationship. For example, a customer may be considered a higher risk customer if he or she seeks to purchase a medium/low risk product, be paying by a high risk method and/or conducting transactions that are out of the ordinary for the typical client within the category profile.
- Group term life insurance – the perceived risk in relationship may increase or decrease depending on factors such as whether the corporate sponsor is a publicly listed company, the number of employees, the value of the contributions, and the options for employee

contributions, cash withdrawals and options for continuation of the policy where employment is terminated. National legislation can allow for reduced CDD in these circumstances in a manner consistent with the FATF standards.

- The regularity or duration of the relationship. The long-standing nature of life insurance typically presents less risk. However, public evidence of financial criminal activity on the part of the customer may cause the insurance company to reconsider the risk posed by the customer, particularly if the policy contains investment elements that can be accessed in demand.
- The use of intermediate corporate vehicles or other structures that have no apparent commercial or other rationale or that unnecessarily increase the complexity of policy ownership or otherwise result in a lack of transparency. The use of such vehicles or structures, without an acceptable explanation, increases the risk.

Controls for Higher Risk Situations

116. Life insurance companies and intermediaries should implement appropriate policies, procedures and controls to mitigate the potential money laundering and terrorist financing risks of those customers, products and countries that they determine pose a higher risk. Risk mitigation measures and controls may include:

- A system to identify and monitor higher risk customers and transactions within business lines across the company.
- Increased levels of CDD or enhanced due diligence. The measures should be directed toward strengthening the knowledge that the life insurance company or intermediary has about the customer with whom they are doing business, that they understand the true source of funds flowing through the product, and that they understand what usual and customary behaviour will look like for the customers purchasing that product.
- Escalation for approval of the establishment of an account/policy/contract or relationship.
- Increased monitoring of transactions (frequency, thresholds, volumes, etc.).
- Increased levels of ongoing controls and frequency of reviews of relationships.

117. The same measures and controls may often address more than one of the risk criteria identified, and it is not necessarily expected that an insurance company establish separate controls, providing that identified heightened risks are addressed.

Chapter Two: Application of a Risk-Based Approach

Customer Due Diligence/Know Your Customer

118. Customer Due Diligence/Know Your Customer is intended to ensure that life insurance companies or intermediaries ascertain the true identity of each customer, beneficial owner and beneficiary of the policy and assess with an appropriate degree of confidence the types of business and transactions the customer is likely to undertake. Consistent with applicable law, the life insurance company or intermediary's procedures should include procedures to:

- Identify and verify the identity of each customer before or during the course of establishing a business relationship.
- Identify the beneficial owner of the customer and, take reasonable measures to verify the identity of the beneficial owner such that the life insurance company or intermediary is satisfied that it knows who the beneficial owner is.
- Identify and verify the identity of the beneficiary of the life insurance contract at or before the time of payout or the time when the beneficiary intends to exercise vested rights under the policy. Normally, and in the absence of indicators of higher risk, the anti-fraud checks regarding the identity of the beneficiary at the time of payout would be adequate.
- Obtain appropriate additional information to understand the customer's circumstances and business, including the purpose and the expected nature of the relationship. Relevant Customer Due Diligence information should be periodically updated as part of the risk assessment process.

119. FATF Recommendation 9 allows a life insurance company to rely on intermediaries such as brokers or other third parties to perform some elements of the CDD process, provided that certain measures are in place. These are¹⁶:

- Immediately obtain from the intermediary or other third party the necessary CDD information.
- Satisfy itself that copies of identification data and other relevant documentation relating to CDD requirements will be made available upon request without delay.
- Satisfy itself that the intermediary or other third party is regulated and supervised and has measures in place to comply with all the CDD requirements and record keeping obligations.
- Rely only on those intermediaries or other third parties in countries which apply adequately the FATF standards¹⁷.
- Recognise that the ultimate responsibility for the customer identification and verification remains with the insurance company. However, intermediaries should also be made responsible for the validity of this information.

¹⁶ Recommendation 9 does not apply to outsourcing or agency relationship (*e.g.* agents)

¹⁷ In determining in which countries the intermediary that meets the conditions can be based, insurance company should consider information received from competent authorities and public information available in mutual evaluation reports issued by the FATF, the IMF, the World Bank and by FATF style regional bodies.

When these conditions are met, the insurance company can rely on the intermediary or third party to perform the CDD requirements as well as the gathering of information on the purpose and the intended nature of the business relationship.

120. In practice, this reliance on third parties often occurs through introductions made by another member of the same financial services group. It may also occur in business relationships between insurance companies and insurance intermediaries.

121. Life insurance companies and intermediaries will determine the due diligence requirements appropriate to each customer. These would normally include a standard level of due diligence, to be applied to all customers.

122. According to national laws, the standard level of due diligence may be reduced in recognized lower risk scenarios, such as:

- Customers, which are publicly listed companies subject to regulatory disclosure requirements.
- Customers which are other financial institutions (domestic or foreign) subject to an AML/CFT regime consistent with the FATF Recommendations.
- Transactions involving de minimis amounts for particular types of transactions such as¹⁸:
 - life insurance policies where the annual premium is no more than USD/€1000 or a single premium of no more than USD/€2500;
 - Insurance policies for pension schemes if there is no surrender clause and the policy cannot be used as collateral;
 - A pension, superannuation or similar scheme that provides retirement benefits to employees, where contributions are made by way of deduction from wages and the scheme rules do not permit the assignment of a member's interest under the scheme (*e.g.* small insurance premiums).

123. The due diligence should be increased in respect of those customers, beneficial owner and beneficiaries that are determined to be of higher risk. This should be the result of the life insurance company or intermediary's assessment of their business activity, ownership structure, anticipated or actual volume or types of transactions, including those transactions involving higher risk countries or defined by applicable law or regulation as posing higher risk, such as PEPs¹⁹ and non face-to-face customers²⁰. When identifying the other factors that could cause a higher risk designation, it is inevitable to list one factor after another, but this does mean that any one factor alone would necessarily trigger a higher risk designation. Identification of multiple factors should result in a correspondingly higher level of enhanced measures.

¹⁸ See Interpretative Note to Recommendations 5 Paragraph 12, listing as examples of where simplified CDD or reduced measures could be acceptable: life insurance where the annual premium is USD/EUR 1000 or a single premium is no more than USD/EUR 2500; insurance policies for pensions if there is no surrender value and the policy cannot be used as collateral; and employee pensions made by way of non-assignable salary deductions.

¹⁹ See FATF Recommendation 6

²⁰ See FATF Recommendation 8

Monitoring of Customers and Transactions

124. The degree and nature of monitoring by a life insurance company or intermediary will depend on the size of the company, the AML/CFT risks that the company has, the monitoring method being utilised (manual, automated or some combination), and the type of activity under scrutiny. In applying a risk-based approach to monitoring, life insurance companies and intermediaries must recognize that not all transactions, accounts/policies/contracts, or customers will be monitored in the same way. In highly automated operations, appropriate risk-based AML/CFT practices may start with filtering out those transactions and customers which need particular monitoring from the large number of transactions which are processed by highly-automated methods. The purpose of the process should be to identify clients whose activities appear to be unusual and which require further analysis to determine if there are grounds for further concern. The degree of monitoring will be based on the perceived risks associated with the customer, the products or services being used by the customer and the location of the customer and the transactions. These monitoring methodologies may change over time based on specific experience with a customer or after general experience by the insurance company as a whole. Monitoring methodologies and processes also need to take into account the overall volume of higher risk situations, resources of the insurance company and the information available for use by the insurance company.

125. The principal aim of monitoring in a risk-based system is to respond to enterprise-wide issues based on each life insurance company or intermediary's analysis of its major risks. Regulatory authorities should, therefore, be mindful of and give due weight to the determinations made by life insurance companies and intermediaries, provided that these determinations are consistent with any legislative or regulatory requirements, and are reasonable and adequately documented.

126. Subject to national legislation, monitoring under a risk-based approach should allow a life insurance company or intermediary to create monetary or other thresholds to identify transactions based on size or type which will be reviewed. Defined situations or thresholds used for this purpose should be reviewed on a periodic basis to determine adequacy for the risk levels established. Changes to systems and processes should be based on the analysis of the effectiveness and efficiency of prior results, new information that would warrant such changes, and the ability of the insurance company to effect such a change. The results of the monitoring should always be documented.

Suspicious Transaction Reporting, including attempted transactions or activities

127. The reporting of suspicious transactions or activity is critical to a country's ability to utilize financial information to combat money laundering, terrorist financing and other financial crimes. Countries' reporting regimes are laid down in national law or regulation, requiring companies to file reports when the threshold of suspicion is reached.

128. Where a legal or regulatory requirement mandates the reporting of suspicious activity once a suspicion has been formed, a report must be made and, therefore, a risk-based approach for the reporting of suspicious activity under these circumstances is not applicable.

129. A risk-based approach is, however, appropriate for the purpose of identifying suspicious activity, for example, by directing additional resources at those areas a life insurance company or intermediary has identified as higher risk. This process is described in the preceding section. As part of a risk-based approach, an insurance company or intermediary should utilize information provided by competent authorities to inform its approach for identifying suspicious activity. A life insurance company or intermediary should also assess on a periodic basis the adequacy of its system for identifying and reporting suspicious transactions.

130. The reason for reporting the suspicious transactions should be documented, either systematically or manually (or a combination). This process should create a comprehensive audit trail and maintained according to applicable recordkeeping requirements.

Training and Awareness

131. Recommendation 15 requires that life insurance companies and intermediaries develop programmes against money laundering and terrorist financing. These programmes should include the provision of AML/CFT training to their employees, which is appropriate and proportional. The commitment of each insurance company or intermediary to having successful controls relies on both training and awareness. This requires an enterprise-wide effort to provide all relevant employees with a minimum level of general information on AML/CFT laws, regulations and internal policies. Ongoing training may take place at a time and in a manner deemed appropriate in keeping with the insurance company or intermediary's overall risk mitigation strategy, and the methodologies may evolve based on specific training experiences or after general experiences of the insurance company as a whole.

132. Applying a risk-based approach to the various methods available for training, however, gives each life insurance company or intermediary additional flexibility regarding the frequency, delivery mechanisms and focus of such training. A life insurance company or intermediary should review its own workforce and agents and available resources and implement training programs that provide appropriate AML/CFT information that is:

- Tailored to the appropriate staff responsibility (*e.g.*, customer contact or operations).
- At the appropriate level of detail (*e.g.*, front-line personnel, complicated products or customer-managed products).
- At a frequency related to the risk level of the business line involved.

133. AML/CFT training should take into account those internal AML/CFT procedures which require that high risk situations are forwarded to and handled by an AML/CFT specialist within the organisation.

Chapter Three: Internal Controls

134. In order for life insurance companies and intermediaries to implement an effective risk-based approach to money laundering and terrorist financing, the risk-based process must be imbedded within the internal controls of the company or intermediary. Senior management is ultimately responsible for ensuring that a life insurance company or intermediary maintains an effective internal control structure, including suspicious activity monitoring and reporting. Strong senior management leadership and engagement in AML/CFT is an important aspect of the application of the risk-based approach. Senior management must create a culture of risk management and compliance, ensuring that staff adheres to the policies, procedures and controls of the life insurance company or intermediary, which are designed to limit and control risks.

135. In addition to other compliance internal controls, the nature and extent of AML/CFT controls will depend upon a number of factors, including:

- The nature, scale and complexity of a life insurance company and the business of its relevant subsidiaries or intermediary's business.
- The diversity of a life insurance company or intermediary's operations, including geographical diversity.

- The life insurance company or intermediary's overall customer, product and activity profile.
- The distribution channels used.
- The volume and size of the transactions.
- The degree of risk assessed within each area of the life insurance company or intermediary's operation.
- The extent to which the life insurance company is dealing directly with the customer or is dealing through intermediaries, third parties, correspondents, or non face to face access.

136. The framework of internal controls should:

- Designate an individual or individuals at management level responsible for managing AML/CFT risk management and compliance, who:
 - Is/are independent of the activities being monitored;
 - Generates the information needed by the Board of directors to obtain an overview of the life insurance company or intermediary with respect to risk management and compliance.
 - Has timely and unrestricted access to customer identification documents, all books, registers, accounts, other accounting records, vouchers and other relevant information.
- Provide increased focus on a life insurance company or intermediary's operations (products, services, customers and geographic locations) that are assessed to be higher risk, including those that have proven to be more vulnerable to abuse based on the past, professional, experience of the life insurance company or intermediary (*e.g.*, matters that have frequently resulted in suspicious transaction reports), as well as advice and information from its industry associations or regulators and law enforcement.
- Provide for regular review of the risk assessment and management processes, taking into account the environment within which the insurance company or intermediary operates and the activity in its market place.
- Provide for an AML/CFT compliance and risk management function and review programme.
- Ensure that adequate controls are in place before new products are offered or when existing product offerings are modified in such a way as to pose an increased ML/TF risk.
- Inform senior management of emerging ML/TF risks and compliance initiatives, identified compliance deficiencies, corrective action taken, and suspicious activity reports filed.
- Provide for programme continuity despite changes in management or employee composition or structure.
- Focus on meeting all regulatory record keeping and reporting requirements, recommendations for AML/CFT compliance and provide for timely updates in response to changes in regulations.
- Implement risk-based customer due diligence policies, procedures and controls.

- Provide for adequate controls for higher risk customers, transactions and products, as necessary, such as transaction limits or management approvals.
- Enable the timely identification of reportable transactions and ensure accurate filing of required reports.
- Provide for adequate supervision of employees that complete reports, grant exemptions, monitor for suspicious activity, or engage in any other activity that forms part of the company's AML/CFT programme.
- Incorporate AML/CFT compliance into job descriptions and performance evaluations of appropriate personnel.
- Provide for appropriate training to be given to all relevant staff.
- For groups, to the extent possible, there should be a common control framework.

137. Senior management will need to have a means of independently validating the development and operation of the risk assessment and management processes and related internal controls, and obtaining appropriate comfort that the adopted risk-based methodology reflects the risk profile of the life insurance company or intermediary. This independent testing and reporting should be conducted by, for example, the internal audit department, external auditors, specialist consultants or other qualified parties who are not involved in the implementation or operation of the insurance company's AML/CFT compliance programme. The testing should be risk-based (focusing attention on the methodology of determining higher-risk customers, products and services); should evaluate the adequacy of the life insurance company or intermediary's overall AML/CFT programme; the quality of risk management for the life insurance company or intermediary's operations, departments and subsidiaries; and include periodic risk-based assessments of high-priority matters and cyclical, comprehensive assessments of procedures and testing.

Whilst by no means an exhaustive list, onsite examination topics may include the following:

- The application of a group-wide policy
- Assessment of the risk associated with each business line
- The extent that assessments have been formally documented and segmented by products, delivery channels, types of customer and geographic location of customers
- Extent of CDD procedures including identification of new customers, customer profiling and collection of 'Know Your Customer' information
- Additional due diligence is undertaken in relation to high risk customers and businesses, e.g. Politically Exposed Persons
- Transaction monitoring procedures in place and how alerts are reviewed
- Policies determining how and on what basis existing customer files may be updated
- Quality of internal systems and controls, including processes for identifying and reporting large cash and suspicious transactions
- Policies on record keeping and ease of retrieving identification evidence or transaction records
- Scope, frequency and audience of AML/CFT training and evaluation of effectiveness
- Appropriate sample testing
- Quality and sufficiency of reporting to senior management and the Board to determine adequacy and effectiveness

There is no set of 'right answers' to these topics. The key considerations are that (a) the insurance company is meeting any minimum regulatory requirements (b) the insurance company has identified its money laundering and terrorist financing risks, worked out how best to manage those risks, and devoted adequate resources to the task; and (c) senior management is properly accountable for AML/CFT controls.

APPENDIX ONE: IAIS INSURANCE CORE PRINCIPLE ON AML/CFT (OCTOBER 2003):

ICP 28 Anti-money laundering, combating the financing of terrorism (AML/CFT)

The supervisory authority requires insurers and intermediaries, at a minimum those insurers and intermediaries offering life insurance products or other investment related insurance, to take effective measures to deter, detect and report money laundering and the financing of terrorism consistent with the Recommendations of the Financial Action Task Force on Money Laundering (FATF).

Explanatory note

28.1. In most IAIS member jurisdictions, money laundering and financing of terrorism are criminal acts under the law. Money laundering is the processing of criminal proceeds to disguise their illegal origin. The financing of terrorism involves the direct or indirect provision of funds, whether lawfully or unlawfully obtained, for terrorist acts or to terrorist organisations.

28.2. Insurers and intermediaries, in particular those insurers and intermediaries offering life insurance or other investment related insurance could be involved, knowingly or unknowingly, in money laundering and financing of terrorism. This exposes them to legal, operational and reputational risks. Supervisory authorities, in conjunction with law enforcement authorities and in co-operation with other supervisors, must adequately supervise insurers and intermediaries for AML/CFT purposes to prevent and counter such activities.

Essential criteria

- a. The measures required under the AML/CFT legislation and the activities of the supervisors should meet the criteria under those FATF Recommendations applicable to the insurance sector²¹.
- b. The supervisory authority has adequate powers of supervision, enforcement and sanction in order to monitor and ensure compliance with AML/CFT requirements. Furthermore, the supervisory authority has the authority to take the necessary supervisory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest or holding a management function in an insurer or an intermediary.
- c. The supervisory authority has appropriate authority to co-operate effectively with the domestic Financial Intelligence Unit (FIU) and domestic enforcement authorities, as well as with other supervisors both domestic and foreign, for AML/CFT purposes.

²¹ See FATF Recommendations 4-6, 8-11, 13-15,17,21-23, 25, 29-32 and 40 as well as Special Recommendations IV, V and the AML /CFT Methodology for a description of the complete set of AML/CFT measures that are required.

d. The supervisory authority devotes adequate resources - financial, human and technical – to AML/CFT supervisory activities.

e. The supervisory authority requires insurers and intermediaries, at a minimum those insurers and intermediaries offering life insurance products or other investment related insurance, to comply with AML/CFT requirements, which are consistent with the FATF Recommendations applicable to the insurance sector, including:

- performing the necessary customer due diligence (CDD) on customers, beneficial owners and beneficiaries;
- taking enhanced measures with respect to higher risk customers;
- maintaining full business and transaction records, including CDD data, for at least 5 years;
- monitoring for complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose;
- reporting suspicious transactions to the FIU;
- developing internal programmes (including training), procedures, controls and audit functions to combat money laundering and terrorist financing;
- ensuring that their foreign branches and subsidiaries observe appropriate AML/CFT measures consistent with the home jurisdiction requirements.

ANNEX 1

SOURCES OF FURTHER INFORMATION

Various sources of information exist that may help both countries and financial institutions in their development of a risk-based approach. Although not an exhaustive list, this section highlights a number of useful web-links that countries and financial institutions may wish to draw upon. They provide additional sources of information, and further assistance might also be obtained from other information sources such as AML/CFT assessments. .

A. Financial Action Task Force Documents

The Financial Action Task Force (FATF) is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing. Key resources include the 40 Recommendations on Money Laundering and 9 Special Recommendations on Terrorist Financing, the Methodology for Assessing Compliance with the FATF Recommendations, the Handbook for Countries and Assessors, methods and trends (typologies) reports and mutual evaluation reports.

www.fatf-gafi.org

B. International Bodies/Organisations

IAIS

International Association of Insurance Supervisors represents some 180 insurance regulators and supervisors of more than 130 countries. Its objectives are to cooperate and contribute to improved supervision of the insurance industry on a domestic and international level in order to maintain efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders; to promote the development of well-regarded insurance markets; and to contribute to global financial stability. IAIS has published principles (*e.g.* Insurance Core Principles and Methodology), standards (*e.g.* Supervisory standard on fit and proper requirements and assessment for insurers) and guidance papers (*e.g.* Guidance paper on AML/CFT; Guidance paper on combating the misuse of insurers; Guidance paper on preventing, detecting and remedying fraud in insurance).

www.iaisweb.org/

Transparency International

Transparency International, the global civil society organisation leading the fight against corruption, brings people together in a powerful worldwide coalition to end the devastating impact of corruption on men, women and children around the world. TI's mission is to create change towards a world free of corruption.

www.transparency.org/

C. Legislation/Guidance on the Risk-Based Approach

Australia

The *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (administered by the Australian Government Attorney-General's Department):

www.comlaw.gov.au/comlaw/management.nsf/lookupindexpagesbyid/IP200627290?OpenDocument
www.comlaw.gov.au/comlaw/management.nsf/lookupindexpagesbyid/IP200627290?OpenDocument

The Anti-Money Laundering and Counter-Terrorism Financing Rules (administered by the Australian Transaction Reports and Analysis Centre):

www.austrac.gov.au/aml_ctf_rules.html

Belgium

Belgium circular of the Banking, Finance and Insurance Commission on the obligations of Customer Due Diligence and Preventing the use of the financial systems for money laundering and the financing of terrorism:

www.cbfa.be/eng/bo/circ/pdf/ppb_2004_8_d_250.pdf

Belgium regulation of the Banking, Finance and Insurance Commission Preventing money laundering and the financing of terrorism:

www.cbfa.be/eng/vt/vz/circ/pdf/regulations_27-07-2004.pdf

Canada

Canada, Office of the Superintendent of Financial Institutions – Guidelines on Deterring and Detecting Money Laundering and Terrorist Financing: Sound Business and Financial Practices

www.osfi-bsif.gc.ca/app/DocRepository/1/eng/guidelines/sound/guidelines/B8_e.pdf

Italy

Parts One and Two of the Bank of Italy's Guidance on Suspicious Activity Reports for all financial intermediaries operating in Italy.

www.bancaditalia.it/vigilanza_tutela/vig_ban/norma/provv;internal&action=lastLevel.action&Parameter=vigilanza_tutela

Japan

Japanese Financial Services Agency – legislation and guidance

www.fsa.go.jp/en/refer/legislation/index.html

Jersey

Financial Services Commission – Guidance note on anti money laundering:

www.jerseyfsc.org/the_commission/anti-money_laundering/guidance_notes/index.asp

South Africa

FIU – General Guidance Note Concerning the Identification of Clients

www.fic.gov.za/info/Guidance%20concerning%20identification%20of%20clients.pdf

United Kingdom, Joint Money Laundering Steering Group (JMLSG) Guidance

UK Industry guidance on anti-money laundering and counter terrorist financing covering good practice application of the law, regulatory requirements and anti-money laundering controls, considered an integral element of the UK AML risk-based approach framework.

www.jmlsg.org.uk

United States

In March 20, 2008, the Financial Crimes Enforcement Network (FinCEN) updated guidance, entitled Frequently Asked Questions Anti-Money Laundering Program and Suspicious Activity Reporting Requirements for Insurance Companies; the guidance was originally issued on October 31, 2005.

www.fincen.gov/statutes_regs/guidance/html/fin-2008-g004.html

On May 31, 2006, FinCEN published frequently asked questions for insurance companies which was not incorporated into the March 20, 2008 publication and, for which insurance companies may continue to rely as guidance.

www.fincen.gov/statutes_regs/guidance/html/insurance_companies_faq.html

General Insurance industry-specific information is also available via FinCEN's homepage; the website references all Insurance industry guidance and additional Insurance industry educational materials.

www.fincen.gov/financial_institutions/insurance

FFIEC Bank Secrecy Act Anti-Money Laundering Examination Manual

www.ffiec.gov/pdf/bsa_aml_examination_manual2006.pdf

D. Information sharing/outreach arrangements between the public and private sector

Section 314 of the USA PATRIOT Act of 2001: Regulations implemented pursuant to section 314 established procedures for information sharing to deter money laundering and terrorist activity. These regulations increase information sharing in two respects: *i*) establishes a mechanism by which federal law enforcement agencies can solicit from financial institutions information related to suspected terrorist activity or money laundering; and, *ii*) encourages financial institutions to share information among themselves in order to identify and report activities that may involve terrorism or money laundering.

www.fincen.gov/po1044.htm

The United States Bank Secrecy Act Advisory Group: Established by the U.S. Congress in 1992, the Advisory Group is chaired by the Director of FinCEN (the US FIU) and serves as the principal forum in which issues related to the administration of the Bank Secrecy Act (BSA) are discussed amongst industry, regulators and law enforcement agencies. The Advisory Group provides advice to the Secretary of the Treasury on ways to enhance the utility of BSA data to law enforcement agencies while minimizing the impact of compliance obligations on affected financial institutions.

<http://uscode.house.gov/download/pls/31C53.txt>

Private Sector Dialogue Programmes: The U.S. has initiated AML/CFT dialogues linking U.S. regulators and financial institutions with their counterparts from the Middle East/North Africa (MENA) and Latin America. This series of outreach events aims to raise awareness of domestic and regional money laundering and terrorist financing risks, international AML/CFT standards and regional developments, and U.S. government policies and private sector measures to combat terrorist financing and money laundering:

www.treas.gov/press/releases/js4346.htm

www.usmenapsd.org/index2.html

E. Other Sources of Information to help assist national and financial institution risk assessment of countries and cross border activities

In determining the levels of risks associated with particular country or cross border activity financial institutions and governments may draw on a range of publicly available information sources, these may include reports that detail observance of international standards and codes, specific risk ratings associated with illicit activity, corruption surveys and levels of international cooperation. Although not an exhaustive list the following are commonly utilised:

- IMF and World Bank Reports on observance of international standards and codes (Financial Sector Assessment Programme)
 - World Bank reports: www1.worldbank.org/finance/html/cntrynew2.html,
 - International Monetary Fund: www.imf.org/external/np/rosco/rosco.asp?sort=topic#RR
 - Offshore Financial Centres (OFCs) IMF staff assessments www.imf.org/external/np/ofca/ofca.asp.
- Mutual evaluation reports issued by FATF Style Regional Bodies:
 1. Asia/Pacific Group on Money Laundering (APG)
www.apgml.org/documents/default.aspx?DocumentCategoryID=8
 2. Caribbean Financial Action Task Force (CFATF)
www.cfatf.org/profiles/profiles.asp
 3. The Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL)
www.coe.int/t/e/legal_affairs/legal_cooperation/combating_economic_crime/5_money_laundering/Evaluations/Reports_summaries_3.asp#TopOfPage
 4. Eurasian Group (EAG)
www.eurasiangroup.org/index-7.htm
 5. GAFISUD
www.gafisud.org/miembros.htm
 6. Middle East and North Africa FATF (MENAFATF)
www.menafatf.org/TopicList.asp?cType=train
 7. Eastern and Southern Africa Money Laundering Group (ESAAMLG)
www.esaamlg.org/
 8. Intergovernmental Action Group against Money Laundering in Africa (GIABA)
www.giaba.org/
- OECD Sub Group of Country Risk Classification (a list of country of risk classifications published after each meeting)
www.oecd.org/document/49/0,2340,en_2649_34171_1901105_1_1_1_1,00.html

- International Narcotics Control Strategy Report (published annually by the US State Department)
www.state.gov/p/inl/rls/nrcrpt/
- Egmont Group membership - Coalition of FIU's that participate in regular information exchange and the sharing of good practice, acceptance as a member of the Egmont Group is based a formal procedure that countries must go through in order to be acknowledged as meeting the Egmont definition of an FIU.
www.egmontgroup.org/
- Signatory to the United Nations Convention against Transnational Organized Crime
www.unodc.org/unodc/crime_cicp_signatures_convention.html
- The Office of Foreign Assets Control ("OFAC") of the US Department of the Treasury economic and trade, Sanctions Programmes
www.ustreas.gov/offices/enforcement/ofac/programs/index.shtml
- Consolidated list of persons, groups and entities subject to EU Financial Sanctions
http://ec.europa.eu/comm/external_relations/cfsp/sanctions/list/consol-list.htm
- UN Security Council Sanctions Committee - Country Status:
www.un.org/sc/committees/

ANNEX 2

CONTRACTUAL RELATIONSHIPS BETWEEN INTERMEDIARIES AND LIFE INSURANCE COMPANIES

1. It is recognized that intermediaries play an important service role in the introduction and placement of life insurance and other investment related insurance products with insurance companies and that as such this role has implications for the Risk-Based Approach to Combating Money Laundering and Terrorist Financing. The FATF in this guidance does not address the differing terminology and interpretations that exist in FATF member countries in relation to the description of an agent or intermediary. The descriptions in this guidance on intermediaries, which term includes agents, are general in nature and designed to give a high level understanding of the differing roles played by each as a distribution channel.

2. Furthermore, most insurance intermediation regulation around the world no longer refers to a distinction between agents and brokers, but adopts an activity-based approach. It relies on disclosure at a contract level so that the consumer, on a contract by contract basis, is aware of the capacity in which the intermediary is acting.

3. When considering contractual relationships between intermediaries and insurers, a wide variety of situations can exist across the world and on a contract by contract basis. In generic terms, as an illustration, the following contractual relationships can be distinguished (descriptive):

- a) The role of an “agent” of a life insurance company is to sell and administer exclusively the insurance investment product of that life insurance company and as such the “agent” can be an employee of the life insurance company. However, an “agent” can also be an individual, sole trader or corporate entity that acts under a contractual arrangement exclusively for the life insurance company for the selling, placement and administration of its insurance investment products.
- b) It is not uncommon for an individual, sole trader or corporate entity to act for more than one life insurance company under a contractual arrangement with the insurer for the selling, placement and administration of a specified insurance investment product.

Generally, these “multi-agency” arrangements are on a product exclusive basis. The agent cannot normally sell the same type of product of more than one insurer.

- c) Another type of intermediary that is involved in the introduction and placement of life insurance and other investment related insurance is known within the life insurance industry as an independent intermediary, often called a broker or an independent financial advisor.

The independent intermediary can be an individual sole trader or corporate entity who is generally regulated within its country of operation to carry out the activity of investment business intermediation in relation to life insurance and on other investment related insurance products. The independent intermediary in conducting its activity will do so in accordance with

the rules and requirements laid down by the supervisory body responsible for licensing such independent intermediary. What distinguishes the independent intermediary from the agent and multi-agent is in most cases the absence of a contractual relationship with one insurer or multiple insurers to place business on an exclusive basis.

4. It is important to note that the above categories can have a different legal definition in different jurisdictions and the above is only a generic description.

ANNEX 3

GLOSSARY OF TERMINOLOGY

Agent

For the purpose of this guidance, agent refers to where the agent is acting under a contractual arrangement with the insurer to carry out its CDD functions *i.e.* the agent is regarded as synonymous with the insurer

Beneficial Owner

The natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement

Beneficiary

For the purpose of this guidance, the *beneficiary* is the person that benefits from the contract. See FATF Methodology, Criteria 5.14.

Competent authorities

Competent authorities refers to all administrative and law enforcement authorities concerned with combating money laundering and terrorist financing, including the FIU and supervisors.

Core Principles

The Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision, the Objectives and Principles for Securities Regulation issued by the International Organisation of Securities Commissions, and the Insurance Core Principles issued by the International Association of Insurance Supervisors.

Designated Non-Financial Businesses and Professions

- a. Casinos (which also includes internet casinos).
- b. Real estate agents.
- c. Dealers in precious metals.
- d. Dealers in precious stones.
- e. Lawyers, notaries, other independent legal professionals and accountants – this refers to sole practitioners, partners or employed professionals within professional firms. It is not meant to refer to ‘internal’ professionals that are employees of other types of businesses,

nor to professionals working for government agencies, who may already be subject to measures that would combat money laundering.

- f. Trust and Company Service Providers refers to all persons or businesses that are not covered elsewhere under these Recommendations, and which as a business, provide any of the following services to third parties:
- acting as a formation agent of legal persons;
 - acting as (or arranging for another person to act as) a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons;
 - providing a registered office; business address or accommodation, correspondence or administrative address for a company, a partnership or any other legal person or arrangement;
 - acting as (or arranging for another person to act as) a trustee of an express trust; acting as (or arranging for another person to act as) a nominee shareholder for another person.

Designated Threshold

The amount set out in the Interpretative Notes to the FATF Recommendations.

Distribution channels

For the purpose of this Guidance, distribution channels are the means through which insurance products and services are provided to a customer. A “distribution” or “producer” is a term applied across all distribution channels and are inclusive of the various terms used to describe those who sell the products offered by insurers.

FATF Recommendations

Refers to the FATF Forty Recommendations and the FATF Nine Special Recommendations on Terrorist Financing.

Financial Institutions

Any person or entity who conducts as a business one or more of the following activities or operations for or on behalf of a customer:

1. Acceptance of deposits and other repayable funds from the public.[5]
2. Lending.[6]
3. Financial leasing.[7]
4. The transfer of money or value.[8]
5. Issuing and managing means of payment (*e.g.* credit and debit cards, cheques, traveller's cheques, money orders and bankers' drafts, electronic money).
6. Financial guarantees and commitments.
7. Trading in:
 - money market instruments (cheques, bills, CDs, derivatives etc.);

- foreign exchange;
 - exchange, interest rate and index instruments;
 - transferable securities;
 - commodity futures trading.
8. Participation in securities issues and the provision of financial services related to such issues.
 9. Individual and collective portfolio management.
 10. Safekeeping and administration of cash or liquid securities on behalf of other persons.
 11. Otherwise investing, administering or managing funds or money on behalf of other persons.
 12. Underwriting and placement of life insurance and other investment related insurance.[9]
 13. Money and currency changing

When a financial activity is carried out by a person or entity on an occasional or very limited basis (having regard to quantitative and absolute criteria) such that there is little risk of money laundering activity occurring, a country may decide that the application of anti-money laundering measures is not necessary, either fully or partially.

In strictly limited and justified circumstances, and based on a proven low risk of money laundering, a country may decide not to apply some or all of the Forty Recommendations to some of the financial activities stated above.

Footnotes:

[5] This also captures private banking.

[6] This includes inter alia: consumer credit; mortgage credit; factoring, with or without recourse; and finance of commercial transactions (including forfaiting).

[7] This does not extend to financial leasing arrangements in relation to consumer products.

[8] This applies to financial activity in both the formal or informal sector *e.g.* alternative remittance activity. See the Interpretative Note to Special Recommendation VI. It does not apply to any natural or legal person that provides financial institutions solely with message or other support systems for transmitting funds. See the Interpretative Note to Special Recommendation VII.

[9] This applies both to insurance undertakings and to insurance intermediaries (agents and brokers).

Intermediary:

For the purpose of this guidance, intermediaries include:

- Other regulated entities: Any financial institution, such as another insurance company, a bank, or a broker-dealer in securities, that is subject to an anti-money laundering regime
- Affiliated producers: A registered representative or producer who is affiliated with a regulated entity other than a life insurer
- Independent producers: A producer or agent who is appointed to sell insurance products by a regulated entity, but who does not sell exclusively for an entity and its subsidiaries
- Internet sales

- Direct mail/solicitations

Legal Arrangements

Legal arrangements refers to express trusts or other similar legal arrangements. Examples of other similar arrangements (for AML/CFT purposes) include fiducie, treuhand and fideicomiso.

Legal Persons

Bodies corporate, foundations, anstalt, partnerships, or associations, or any similar bodies that can establish a permanent customer relationship with a financial institution or otherwise own property.

Politically Exposed Persons (PEPS)

Individuals who are or have been entrusted with prominent public functions in a foreign country, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials. Business relationships with family members or close associates of PEPs involve reputational risks similar to those with PEPs themselves. The definition is not intended to cover middle ranking or more junior individuals in the foregoing categories.

Shell Bank

Bank incorporated in a jurisdiction/country in which it has no physical presence and which is unaffiliated with a regulated financial group.

Supervisors/Regulators

The designated competent authorities who have responsibility for ensuring compliance by financial institutions with requirements to combat money laundering and terrorist financing.

ANNEX 4

MEMBERSHIP OF THE ELECTRONIC ADVISORY GROUP

FATF Members & Observers

Argentina, Belgium, Canada, France, Portugal, South Africa, Spain, Switzerland, UK, US, GIABA, IAIS, MENAFATF, MONEYVAL, OGBS, UN, World Bank

Insurance industry

Canada	The Canadian Life and Health Insurance Association Independent Financial Brokers Zurich Financial Services Group
Finland	IF
Germany	Allianz Group <i>Gesamtverband der Deutschen Versicherungswirtschaft e.V</i>
Japan	Life Insurance Association of Japan
Switzerland	Swiss Insurance Association
UK	Association of British Insurers Lloyds
US	Aegon American Council of Life Insurers (ACLI) Assurant AXA Financial Hartford Financial Services Group Howrey LLP

LIMRA International

Lincoln Financial Group

Midland National Life Insurance Company

Nationwide Mutual Insurance Company.

Pacific Life Insurance Company

Prudential Financial, Inc.

Sun Life Assurance Company

Willis Group

Winne, Banta, Hetherington, Basralian & Kahn, P.C.

CEA - European insurance and reinsurance federation

National Association of Insurance and Financial Advisors