

MONEY LAUNDERING AND TERRORIST FINANCING RISKS IN THE INSURANCE INDUSTRY*

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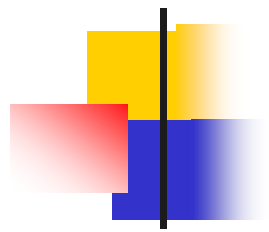
MONEY LAUNDERING AND TERRORIST FINANCING RISKS IN THE INSURANCE INDUSTRY

PART 1

INTRODUCTION

- Anti-money laundering (AML) and combating the financing of terrorism (CFT) have become key global concerns, particularly after the 9/11 terrorist attacks in the U.S. This increased attention is in recognition of the fact that money laundering and terrorist financing are global phenomena and that these criminal activities pose major threats to international peace and security and could also seriously constrain national development and progress.
- Thus, concerted global efforts have been made to check these crimes. Financial institutions have come under unprecedented regulatory pressure to enhance their monitoring and surveillance systems with a view to preventing, detecting and responding appropriately to money laundering and terrorist financing. Players in the financial services sector are exposed to varying money laundering and terrorist financing risks and could suffer serious financial and reputational damage if they fail to manage these risks adequately.

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- ❑ Thus, the initial regulatory focus was on banks because they were perceived to be the most vulnerable, given the variety, size and complexity of their operations which could readily be exploited and abused by criminals. However, with increased compliance by banks with AML/CFT requirements, criminals have sought to exploit the loopholes afforded by other financial service providers and non-financial businesses and professions which were either not regulated or subjected to rigorous monitoring and controls.
 - ❑ Accordingly, global action under the auspices of the Financial Action Task Force (FATF), the Basel Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO), has resulted in the emergence of best practice guidance papers integrating the FATF 40+9 Recommendations for adoption by other financial institutions and non-financial businesses and professions.
 - ❑ Furthermore, various national jurisdictions, including those in ECOWAS, have politically committed themselves to combating money laundering and terrorist financing by adopting the FATF standards. Thus, they impose certain statutory AML requirements on these non-bank institutions, including insurance companies. In particular, AML laws in all ECOWAS member-states not only designate money laundering and predicate offences but also prescribe criminal sanctions for non-compliance with the relevant laws and regulations.

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- ❑ Implementation of these new regulations would be challenging, burdensome and costly. However, properly considered, it is a strategic imperative and operators, including those in the insurance industry, fail to implement them at their peril, given that the regulatory fines and sanctions and reputational damage that they are exposed to for non-compliance, could have a devastating economic and financial impact on the affected institutions.
 - ❑ Furthermore, apart from the need to avoid sanctions, the need to be perceived as being compliant and pursuing best practices in the conduct of the business of a company, is a unique selling point which could enhance customer goodwill and competitive advantage, especially at a time when customers increasingly place a premium on good business ethics. Thus, being AML/CFT compliant not only means staying on the right side of the law and thereby avoid fines but it also generates good business. The above assertion is compelling when put in the context of the prevailing low AML/CFT awareness and compliance status in the regional insurance industry.
 - ❑ Accordingly, it is hoped that the insights mediated during this session would serve the purpose of furthering the regional stakeholder sensitisation efforts of GIABA and improve the compliance status of operators in the insurance industry.

PART 2

OVERVIEW OF THE INSURANCE INDUSTRY – Features, Roles and Recent Developments

- ❑ The insurance industry is a key component of the financial services sector. Thus, various countries have initiated measures for the development and effective regulation of the industry. As a result of these measures, the insurance industry in most ECOWAS member-countries has grown over the years, in terms of the number of companies, customer base, intermediaries and asset base. Their underwriting capacity and risk retention have also increased, especially in those countries that have undergone recapitalisation/consolidation exercises.
- ❑ In spite of these achievements, the insurance industry in most, if not all, of the ECOWAS countries is bedevilled by numerous negative features and problems which have AML/CFT implications.

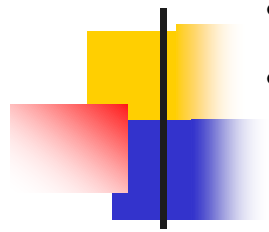


Nigeria as a Case Study in Insurance Industry Development and Emerging Challenges.

- ❑ The insurance industry in Nigeria has had a long history and undergone several reforms, the latest of which was the 2005/2007 regulatory-induced recapitalisation exercise. The latest reform was intended, inter alia, to enhance the underwriting capacity and ability of local insurance companies to participate in certain key sectors such as oil and gas, strengthen their viability and significantly increase the industry's contribution to the growth of the Nigerian economy.
- ❑ The performance of the Nigerian insurance industry post-consolidation is a mixed bag of good and bad news.

Positive Achievements/Developments

- Improved capital base.
- Rebranding and improvement of corporate/industry image.
- Improved underwriting capacity and ability to participate in sectors such as oil and gas, marine insurance and fire insurance, hitherto the exclusive preserve of foreign insurance companies.
- Increased ability to attract and retain talents.
- Late-starter advantage – replicating the strategies of successful mega-banks and internalising the lessons learnt, without incurring the cost of trial and error.
- Increased interest by local banks and foreign insurance firms in the industry and prospects for the bancassurance business model as a strategic option.
- Increased prospects for life insurance business following the resolve of the National Pension Commission (PENCOM) to implement sections 3(2) and 9(3) of the Pension Reform Act, 2004 on statutory group life insurance.
- Enhanced prospects for various non-life businesses as NAICOM and insurance operators work together to enforce compliance with the provisions of the Insurance Act of 2003 which makes 16 insurance products compulsory.

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- The implementation of the local content policy.
 - A vast untapped market, implying substantial growth potential.
 - Establishment of cross-border subsidiaries and businesses in several African countries.

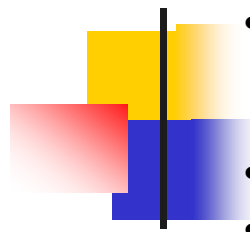
Weaknesses and Lapses

- As comforting as the above achievements and prospects are, Nigeria's insurance industry post-consolidation manifests a number of long-standing weaknesses, including the following:
- A lingering image problem arising from poor public perception.
- Low level of insurance awareness and penetration, resulting in low demand for insurance services and products.
- Poor governance practices.
- Poor financial performance.
- Fraudulent practices.
- High level of unsettled claims.

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- Poor collection efficiency and high level of accounts receivable.
 - Stiff competition and price wars.
 - Shortage of skilled manpower to undertake life business and participate in highly specialised transactions on a meaningful scale, especially oil and gas, marine and aviation.
 - Low level of I.T. infrastructure, investment and deployment.
 - Unsophisticated product offerings.
 - Inadequate regulatory capacity and effectiveness.

- Thus, despite the gains of the recent consolidation, the Nigerian insurance industry is still grossly underperforming, relative to its great potential, and remains largely underdeveloped. It is also a dismal underperformer relative to the banking industry in terms of total deposits vis-à-vis gross premium income and total assets.
- Although there are varying features, performance levels and trends in the national insurance industry in ECOWAS member-states, the Nigerian case as highlighted above aptly exemplifies the opportunities and challenges that prevail throughout the region. Thus, it has implications for AML/CFT control and effectiveness which would be addressed later in this presentation.

PART 3

MONEY LAUNDERING RISKS AND VULNERABILITIES IN THE INSURANCE INDUSTRY

Definitions of ML and TF


- ❑ As a point of departure and to make for clarity of concepts, we need to provide some working definitions here.
 - According to the IAIS Guidance Paper on AML/CFT, “**Money laundering** is the processing of the proceeds of crime to disguise their illegal origin. Once these proceeds are successfully ‘laundered’ the criminal is able to enjoy these monies without revealing their original source. Money laundering can take place in various ways.”
 - Also, according to IAIS, “**Financing of terrorism** can be defined as the willful provision or collection, by any means, directly or indirectly, of funds with the intention that the funds should be used, or in the knowledge that they are to be used, to facilitate or carry out terrorist acts. Terrorism can be funded from legitimate income.”

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How vulnerable is the insurance industry to AML/CFT risks?




□ The introduction to the Guidance Paper on Anti-Money Laundering and Combating the Financing of Terrorism issued in October, 2004 by the International Association of Insurance Supervisors (IAIS) (the authoritative global body that sets international standards for the insurance industry) states as follows:

- “The insurance sector and other sectors of the financial services industry are, potentially, at risk of being misused for money laundering and the financing of terrorism.The products and transactions of insurers can provide the opportunity to launder money or to finance terrorism”.
- The introduction states further: “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 for those seeking resources for terrorist acts or for ways to process funds to accomplices. Insurers can be involved, knowingly or unknowingly, in money laundering and the financing of terrorism.”

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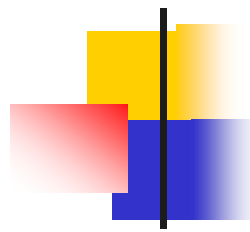
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□ The import of the above statements is that money laundering and financing of terrorism risks exist in the insurance industry, although not as severe as in other sub-sectors of financial services, such as banking. Nevertheless, this should not provide room for complacency either by insurance regulators or by insurers. Indeed, the following factors provide grounds for concern over the increasing vulnerability of insurance to money laundering and potentially to terrorist financing:

- The various types of insurance business and contracts that have been found to be vulnerable as vehicles for ML/TF, encompassing life, non-life and re-insurance transactions. *
- With the increased AML/CFT focus and control measures on traditional financial institutions, such as banks, non-bank financial institutions with weak AML/CFT control measures have become increasingly attractive to money launderers.
- Competitive pressures, especially during times of economic recession, such as the prevailing global economic meltdown, tend to spawn criminal shortcuts and survival strategies that undermine AML/CFT compliance by marginal operators and distressed firms which cannot afford the resources required to diligently implement an effective AML/CFT compliance programme. Thus, they provide safe havens for the laundering of criminal proceeds.


*See Appendices 1 and 2 for ML/TF "red flag" indicators and typologies.

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- These constraining factors have global relevance and may operate with even greater force in a developing-world environment, such as ECOWAS. This state of affairs is exacerbated by region-specific factors such as: competing priorities for scarce government resources; severe lack of resources and skilled manpower to implement AML/CFT measures; the prevalence of informal or unregistered operators; a weak regulatory/supervisory and law enforcement environment; the dominance of cash transactions which are susceptible to money laundering; and entrenched corruption.

□ Thus, AML/CFT risks in the insurance industry in ECOWAS are not only real but possibly growing. The significant growth of the regional insurance industry which is bound to happen through developments, such as: the growth of GDP; cross-border activities; policy-induced growth in life business and other compulsory insurance products; etc, is likely to have mixed consequences for the AML/CFT compliance regime.

- On the one hand, increased industry growth would create an enabling environment for instituting a compliance culture, with the emergence of bigger and more viable insurers which have a strategic interest in, and can afford the financial resources required for, implementing comprehensive AML/CFT compliance programmes, in the face of envisaged increased regulatory/supervisory effectiveness. Thus, such insurers face the risk of legal sanctions and fines as well as reputational damage if they fail to comply.

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- ❑ On the other hand, with a growing insurance industry and increased technological sophistication, there would be increased volumes and complexity of operations which could easily be exploited for money laundering and terrorist financing.
 - ❑ Going forward, both the regulators and the operators in the insurance industry in ECOWAS need to be alert to the prevailing or emerging ML/TF risks and evolve appropriate control measures. Fortunately, the task is made easier because there is a wealth of international standards and best practices which they could adopt or adapt. This is a matter for our consideration in the next part of this presentation.

PART 4

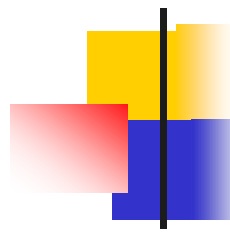
OVERVIEW OF GLOBAL AML/CFT STANDARDS AND BEST PRACTICES FOR THE INSURANCE INDUSTRY

- ❑ As noted earlier, a number of global initiatives have been taken since the 1980's to promote cooperation among regulators and international financial institutions towards setting international standards. One of these key international standard-setters is the International Association of Insurance Supervisors (IAIS) which was established in 1994.

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- ❑ The IAIS has given AML/CFT issues high priority. Accordingly, in October 2003, the Association revised and expanded its Insurance Core Principles and Methodology, which is a requirement for effective insurance system supervision. As part of that revision, a new Insurance Core Principle (ICP) 28 was introduced, dealing specifically with anti-money laundering and combating the financing of terrorism. The thrust of ICP 28 is that the Recommendations of the FATF applicable to the insurance sector and to insurance supervision must be met if the insurance supervisory system is to be effective.*

 - ❑ Furthermore, in October, 2004, the IAIS adopted a Guidance Paper on Anti-Money Laundering and Combating the Financing of Terrorism, replacing the AML Guidance Notes for Insurance Supervisors and Insurance Entities which had been issued in January, 2002. The 2004 Guidance Paper took into account the revised FATF 40+8 Special Recommendations which are considered the international standards in the field of AML/CFT for insurance supervisors and the insurance industry.

*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.

The highlights of the 2004 Guidance Paper are as follows:

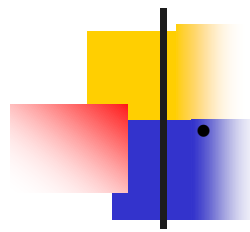


Core Principles

- Compliance with AML/CFT laws.
- Implementation of “Know Your Customer” procedures.
- Cooperation with all law enforcement agencies.
- Implementation of internal AML/CFT policies, procedures and training programmes for employees.


Other Key Elements

- The paper applies to those insurers and intermediaries offering life insurance products or other investment-related insurance and sets minimum AML/CFT standards for those entities. Nevertheless, jurisdictions or supervisors should be alert to the potential risks posed by non-life insurance and reinsurance and take appropriate measures beyond the scope of the FATF Recommendations, following a risk-based analysis.

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- Definitions of money laundering and terrorist financing.
 - Vulnerabilities in insurance, types of insurance products and contracts susceptible to ML/TF misuse and specific examples of money laundering in the insurance industry.
 - Formulation and implementation of internal control measures and procedures against money laundering and financing of terrorism.

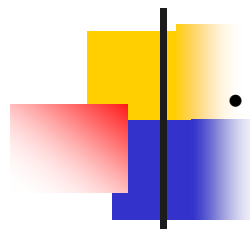
The internal control measures include:

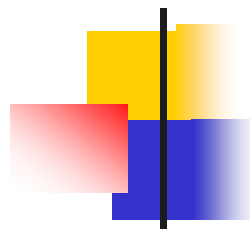
- Programmes to assess the risks related to money laundering and terrorist financing and the duty of vigilance.
- Customer due diligence procedures.
- Enhanced due diligence with respect to persons and businesses carrying high risks, including politically-exposed persons and persons in jurisdictions that do not have adequate AML/CFT regimes.
- Measures and procedures for the reporting of suspicious transactions.
- AML/CFT record keeping.
- Screening and training of staff.

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- ❑ In October 2008, the IAIS issued a Guidance Paper on the Regulation and Supervision of Captive Insurers. The Paper identifies those representing the highest regulatory risk as “captives underwriting risks for unrelated party policyholders or underwriting compulsory third party liability risks.”
 - ❑ Also, in October 2009, the FATF issued a Guidance Paper on risk-based approach to AML/CFT in the insurance industry. Although it is neither mandatory nor prescriptive, the Paper is an authoritative, standard-setting document which will surely be taken seriously by insurance regulators and other key stakeholders in the industry.

Review and Appraisal of the Regional AML/CFT Regime for the Insurance Industry

- ❑ Various Mutual Evaluation Reports, Typologies Studies, GIABA Annual Reports and other authoritative reports, and anecdotal evidence all provide a firm basis for the following insights and conclusions on the prevailing AML/CFT regime for the insurance industry.

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- All member-countries of ECOWAS have separate AML laws which apply to insurance companies.
 - A draft model stand-alone CFT legislation was adopted at the GIABA Plenary Meeting in 2007 and the UEMOA Commission has since issued a Directive adopting the draft model legislation and requiring its members to domesticate and enact national CFT legislations in line with the uniform model legislation.
 - In the non-UEMOA countries i.e., the common law, English-speaking jurisdictions, efforts are being made to formulate a CFT model law for domestication.
 - Significant progress has been made in establishing functional FIUs in most member-countries.
 - There are institutional arrangements for the regulation and supervision of insurance companies and improved enforcement measures have been recorded in a number of countries.

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- Nevertheless, the regional regulatory/supervisory regime for the insurance industry is grossly inadequate. Indeed, implementation of AML/CFT measures in the industry is constrained by a number of factors, including: inadequate resources, in terms of funds and skilled manpower on the part of both the regulators and the operators; absence of functional FIUs in some countries; inadequate inter-agency coordination, resulting in regulatory arbitrage; low level of stakeholder awareness and commitment and the perception that ML/TF risks are not serious; and lack of the political will to diligently implement the AML/CFT laws.
 - Furthermore, implementation, in terms of cases investigated and prosecuted by law enforcement agencies and decided upon by the law courts, is largely unsatisfactory. Above all, the prevailing entrenched corruption does not provide a conducive environment for AML/CFT effectiveness.

PART 5

CONCLUSION

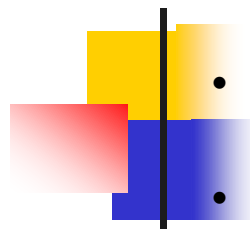
ENHANCING AML/CFT COMPLIANCE IN THE INSURANCE INDUSTRY– A Stakeholder Approach

- ❑ The task of enhancing AML/CFT compliance in the insurance industry should be seen as a matter of shared responsibilities among the key stakeholder-groups, encompassing: Government/Competent Authorities; the operators; regional and non-regional development partners; and local and international professional/trade groups. The rationale for adopting a stakeholder approach is that it promotes cooperation and engenders a sense of partnership and ownership in the implementation of a robust AML/CFT regime.

- ❑ The roles of the respective key stakeholder may be highlighted as follows:

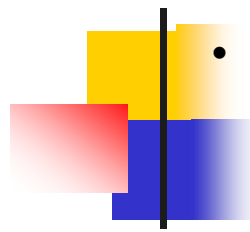
Government/Competent Authorities

- Updating and strengthening the enabling AML/CFT regimes, consistent with international standards and best practices e.g. AML/CFT model law for common law jurisdictions, establishing functional FIUs, etc.

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- Creating an enabling policy and macroeconomic environment to minimise or eliminate distortions and competitive inequities and thereby foster voluntary compliance and self-regulation.
 - Fostering the emergence and viability of Self-Regulatory Organisations.
 - Conducting outreach and awareness-raising campaigns for the private sector, particularly insurance companies and their related trade groups.
 - Supporting training and institution-building programmes for insurance companies.
 - Disseminating ML/TF typologies, “red flag” indicators and sanitised case studies to insurance companies to enhance their understanding and compliance.
 - Fostering consultation and dialogue with stakeholders at the overall policy and strategic levels.

GIABA and Development Partners/Donor Agencies

- Raising awareness of insurance companies, agents and intermediaries about the impact and implications of money laundering and terrorist financing.

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- Promoting the effective functioning of FIUs in ECOWAS member-countries, as a key element of AML/CFT compliance.
 - Funding and technical support for the capacity and institution-building efforts of insurance companies through collaborative training programmes, providing resource materials and disseminating ML/TF typologies, “red flag” indicators and sanitised case studies, for enhanced compliance.

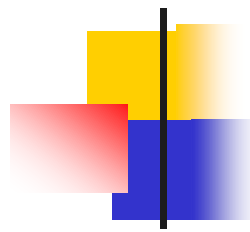
Individual Insurance Companies


- Recognising that they are exposed to various money laundering and terrorist financing risks and possible financial and reputational damage if they violate relevant laws and regulations, individual insurance companies should adopt policies stating their commitment to comply with AML/CFT obligations under the law.
- In many jurisdictions, the ultimate responsibility for AML/CFT compliance is placed on the Board/Top Management. It is, therefore, imperative that the Board ensure that a comprehensive compliance programme, including internal control measures and the training and education of staff, etc, is in place.

Professional Trade Groups (SROs)

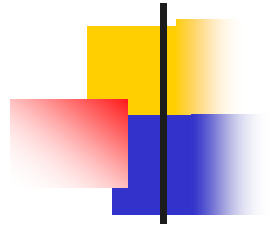
Their collective roles are to:

- Issue guidelines, rules and procedures, consistent with the letter and spirit of the AML/CFT laws and ensure diligent implementation by their members.
 - Prescribe minimum standards for the conduct of business and to take disciplinary action against their erring members.
 - Encourage a high level of professionalism and ethical conduct.
- From the various constraints and the checklist of stakeholder responsibilities highlighted above, it is clear that the task of instituting and enhancing AML/CFT compliance in the regional insurance industry, consistent with international standards, is a daunting one. However, it is achievable if certain requirements are in place, including the following:
- First, there must be demonstrable political will as manifested not only in the willingness to adopt international AML/CFT standards but also in diligent implementation by providing the necessary resources and by Government/Regulatory Authorities holding themselves accountable and living by the high governance standards which they prescribe for market operators.

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- Second, building effective public-private sector cooperation and partnership to enlist the support of, and engender a sense of policy ownership among, the key insurance industry stakeholders in the fight against money laundering and terrorist financing. This is particularly important, given the prevailing executive capacity and resource constraints of the regulatory authorities.
 - Third, given the resource constraints and the differing circumstances of insurance companies, adoption of a risk-based approach should be promoted to ensure that the AML/CFT controls are appropriate, proportionate and cost-effective for managing the risks faced by the enterprise.
 - Fourth, there should be collective regional action at the level of governments to commit each member-country to the full adoption of the FATF/IAIS AML/CFT standards and their uniform and consistent application throughout, thereby ensuring that there are no weak links in the regional control chain. This should be backed by a peer review mechanism (mutual evaluation) with scope for moral suasion.

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- Fifth, given the various constraints faced by low-income countries, such as most ECOWAS member-countries, in adopting and implementing international AML/CFT standards, a phased and sequenced approach is called for to enable them build the necessary capacity and confidence that would make such adoption effective and sustainable. In this connection, it is instructive that the Guidance Paper on Capacity Building for Mutual Evaluations and Implementation of the FATF Standards within Low Capacity Countries (LCCs) issued by the FATF on 29th February, 2008, acknowledges the severe lack of capacity and resources which constrain AML/CFT implementation efforts of LCCs. Accordingly, while stressing that full and effective roll-out of the FATF standards in all countries is one of its fundamental goals, the FATF standards allow countries a measure of flexibility in implementing the principles set out in the standards. This calls for prioritisation and sequencing of measures, beginning with the core FATF Recommendations.*

- In conclusion, it should be stressed that although insurance companies in ECOWAS countries have serious constraints in adopting and implementing AML/CFT international standards, they need to understand that in our post 9/11 World, being compliant is not an option but a legal and strategic imperative. It is, therefore, in their best interest to make concerted efforts with other stakeholders to build the capacity and mobilise the required resources to make it happen in good time.



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