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New Regulations Require Insurance Companies To Implement Anti-Money Laundering Programs

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After three years of research and review, the U.S. Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") issued regulations requiring insurance companies to implement compliance programs to prevent money laundering in insurance products. The regulations were issued pursuant to the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "Patriot Act") and the Bank Secrecy Act ("BSA"). The BSA is a federal disclosure law designed to assist the government in preventing and detecting money laundering. Under the BSA, financial institutions must maintain records of various currency transactions which are designed to assist law enforcement in tracing funds derived from illegal activity. The Patriot Act expanded the scope of the BSA to cover terrorist financing. FinCen's insurance company regulations were issued on November 3, 2005, take effect on December 5, 2005, and require insurance companies to implement anti-money laundering programs on or before May 2, 2006. 31 C.F.R. § 103. (available at http://www.fincen.gov/amlforinsurancecompany.pdf).

Why the Concern?

The regulations are designed to prevent insurance products from being used to launder the illegal proceeds of crime. Consequently, the regulations cover only those insurance products that FinCen deems "susceptible to being used for money laundering or the financing of terrorism."

Who is Covered?

Insurance companies are covered but insurance agents and brokers are not. The Rule defines an insurance company as: "any person engaged within the United States as a business in the issuing or underwriting of any covered product." Although the Rule excludes insurance agents and brokers from the definition of "insurance company," insurance companies are required to train and oversee compliance by their agents and brokers.

Timeline

November 3, 2005: FinCen's insurance company regulations issued.

December 5, 2005: FinCen's regulations take effect.

May 2, 2006: Insurance companies required to implement anti-money laundering programs.

What Insurance Products are Covered?

The term "covered product" is defined to include: (i) A permanent life insurance policy, other than a group life insurance policy; (ii) any annuity contract, other than a group annuity contract; and (iii) any other insurance product with features of cash value or investment.

What Insurance Products Are Excluded?

Property and casualty insurance policies are excluded. Term life (which includes credit life) and group life insurance products, group annuities, and insurance products offered by title and health insurers are also excluded.

What "Red Flags" May Signal Money Laundering?

The Federal Register notice accompanying FinCen's announcement of the final rule includes a list of potential "red flags" that may indicate the misuse of "covered products" for money laundering or terrorist financing, including:

- the purchase of an insurance product inconsistent with the customer's needs;
- 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;
- early termination of a product, 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;
- the transfer of the benefit of a product to an apparently unrelated third party;
- a customer who shows little concern for the investment performance of a product, but much concern about the

early termination features of the product;

- a customer who is reluctant to provide identifying information when purchasing a product, or who provides minimal or seemingly fictitious information;

- and a customer who borrows the maximum amount available soon after purchasing the product.

See 70 Fed. Reg. 66754, 66759 (Nov. 3, 2005) (stating that anti-money laundering program training must be designed to help responsible personnel identify "red flags" associated with covered insurance products).

What Is Required?

The Rule sets forth minimum requirements for an anti-money laundering program for insurance companies.

Policies, procedures and internal controls reasonably designed to prevent insurance products from being used to launder money or finance terrorist activities.

Each insurance company should identify its vulnerabilities to money laundering and terrorist financing activity, identify the risk factors relating to these requirements, and design the procedures and controls that will be required to reasonably ensure compliance with these requirements. The regulations require that each financial institution tailor its program to fit its business, taking into account factors such as size, location, activities and risks or vulnerabilities to money laundering. Insurance companies are required to establish a paper trail showing that they obtained information leading them to reasonably believe that policies are not being used for laundering purposes.

An insurance company that identifies suspicious activity must take reasonable steps to determine if its suspicions are justified and respond accordingly. The response could include refusing to enter into a transaction that appears designed to further illegal activity. It is a crime for any person, including an individual or company, to engage knowingly in a financial transaction with the proceeds from any of a long list of crimes or "specified unlawful activity," and that "knowingly" includes not only "actual knowledge" but also "willful blindness."

Insurance companies that contractually delegate the operation of certain aspects of anti-money laundering programs to their agents remain fully responsible for compliance with the regulations. In addition, insurance companies must train their insurance agents and brokers concerning the company's anti-money laundering program. Each insurance company's program must be approved by senior management. The term "senior management" is not defined in the Rule.

Independent testing of compliance to be conducted by company personnel or by a qualified outside party.

Insurance companies must periodically test their programs to ensure that the programs are functioning as designed. Such testing should be accomplished by personnel knowledgeable about relevant money laundering risks as well as BSA requirements. The frequency of such a review depends upon factors such as the size and complexity of the insurance company's operations and the extent to which its business model may make it more vulnerable to money laundering than other institutions. A written assessment or report should be a part of the review, and any recommendations resulting from such review should be promptly implemented or submitted to senior management for consideration. The requirement that the company personnel responsible for the compliance testing function be separate from those responsible for operating the anti-money laundering program may make it necessary for smaller firms to retain outside compliance testing assistance.

Designated Compliance Officer.

Each insurance company must charge an individual (or committee) with the responsibility for overseeing the anti-money laundering program. The person (or group) should be competent and knowledgeable regarding BSA requirements and money laundering issues and risks, and empowered with full responsibility and authority to develop and enforce appropriate policies and procedures throughout the company. Whether the compliance officer is dedicated full time to BSA compliance depends upon the size and complexity of the company. Although, in some cases, the implementation and operation of the compliance program will be conducted by entities (and their employees) other than the insurance company, the person responsible for the supervision of the overall program should be an insurance company officer, trustee, general partner, organizer, operator or sponsor, as appropriate.

Ongoing training for appropriate persons regarding the BSA requirements that are relevant to their functions and the signs of money laundering that could arise in the course of their duties.

Training can be conducted by outside or in-house seminars, and can include computer-based training. The level, frequency and focus of the training would be determined by the responsibilities of the employees and the extent to which their functions bring them in contact with BSA requirements or possible money laundering activity. Consequently, the training program should provide both a general awareness of overall BSA requirements and money laundering issues, as well as more job-specific guidance regarding the particular employee's role and function in the anti-money laundering program. Appropriate topics for an anti-money laundering program include, but are not limited to, BSA requirements, a description of money laundering, how money laundering is carried out, what types of activities and transactions should raise concerns, what steps should be followed when suspicions arise, and the Office of Foreign Assets Control and other government agency lists.

The final Rule requires each insurance company to establish anti-money laundering policies, procedures, and internal controls reasonably designed to integrate its agents and brokers into its anti-money laundering program and to monitor their compliance with its program. FinCen makes clear that this aspect of the final Rule will be monitored on an ongoing basis, and that necessary changes will be adopted in the future to ensure the final Rule's effectiveness. In addition, the Rule provides flexibility to insurance companies in determining whether to directly train its agents and brokers, or to rely upon training programs of another company for agents and brokers that sell products on behalf of multiple insurance companies. The final Rule acknowledges and permits agent and broker training by competent third parties, such as another financial institution that is required to establish an anti-money laundering program.

Suspicious Activity Reporting

FinCen also released a counterpart rule for insurance companies regarding Suspicious Activity Reports ("SAR"), and issued a notice and request for comment regarding an insurance company-specific SAR form. Written comments are due on or before January 3, 2006.

FinCen's SAR rule sets out both encouraged and required activity by insurance companies. The SAR rule encourages insurance companies to report any transaction that appears relevant to a violation of law or regulation, and requires insurance companies to report any transaction involving $5,000 or more in funds or other assets, if the insurance company knows, suspects, or has reason to suspect that the transaction: (i) involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity; or (ii) is designed, whether through structuring or other means, to evade the requirements of the BSA; or (iii) has no business or apparent lawful purpose, and the insurance company knows of no reasonable explanation for the transaction after examining the available facts; or (iv) involves the use of the insurance company to facilitate criminal activity.

What Paul Hastings Can Do

Our lawyers have substantial experience counseling clients in anti-money laundering compliance. If you have any questions concerning this or any other matter, please contact any one of us:

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