Anti-Money Laundering

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What is Money Laundering?

Taken at its simplest, money laundering is a process by which the origins and ownership of money, generated as a result of criminal activity, can be concealed. In effect, the money is 'cleaned' or 'laundered' through legitimate means and, as a result, the proceeds lose their existing criminal identity and appear to have originated from a legitimate source.

History

Money laundering has been around for at least 2,000 years when Chinese merchants cycled money through various businesses and complex financial transactions to hide the income from government bureaucrats. But the term gained glamour only when the accountant of Al Capone found it difficult to explain the source of money obtained from illegal activities. This accountant purchased cash-only laundromats and used them as a front, in order to disguise the source of the dirty money they were getting from prostitution, bootlegged liquor sales and other criminal activities.

Laundering Costs the UK

£37 Billion

Each year

Today TV shows from Netflix and Amazon portray criminals laundering money by carrying bags of "dirty" money to casinos, but the reality is that serious and organised crime, which flourishes when criminals can launder the proceeds of their illicit activities, is estimated to cost the UK at least £37 billion each year (source National Crime Agency). The insurance market due to its complexity, products and structure provides an ideal opportunity for criminals to launder money.

Fighting Money Laundering

To counter the problem there is UK anti-money laundering legislation which is dictated by the Proceeds of Crime Act 2002 (POCA), the Terrorism Act 2000 and the Money Laundering, Terrorist Financing and Transfer of Funds 2017. The UK is a member of The Financial Action Task Force ('FATF') and, accordingly, the UK anti-money laundering legislation meets FATF's global standards. The laws and regulations target criminal activities including market manipulation, trade in illegal goods, corruption of public funds, and tax evasion, as well as the methods that are used to conceal these crimes and the money derived from them.

The FCA is empowered to impose fines and bring criminal prosecutions for breaches of money laundering regulations.

The Money Laundering Process

1. Placement

The money laundering process begins with the placement stage, whereby proceeds of crime make their initial entry into the insurance system whether via insurers, brokers and MGAs with criminals hiding its source. Whilst any firm and product type can be targeted some activities provide a greater opportunity for criminals:

- Annuity policies or high regular premium savings
- Electronic and arms-length trading
- Cooling-off periods
- Single premium policies
- Employee collusion
- Policy surrender
- Top-ups
- Transferring ownership
- Policy loans
- Secondary life market

Insurance firms need to be aware that the bank accounts used in money laundering are generally opened in the name of a business. These are called a front, as the legitimate appearance corporate appearance offers as a disguise for the illegal sources of the cash.

Often times, multiple small transactions are made so as to fall below the 'monitoring radar' of firms and ensuring that no detailed due diligence checks are made. Through this process money loses some of its origins, particularly when it is subsequently withdrawn or used to purchase further assets, such as insurance policies.

The most common form of money laundering that insurance institutions will face is by entering into a single premium contract. Money launders will then attempt to get the money back through a fraudulent claim, cancellation or amendment.

2. Layering

Once cash has entered the insurance system, launderers "layer" financial transactions to obscure any trail that links them to the origin of the cash. Layering can be done by purchasing legitimate assets and selling them on, transferring them to a legitimate third party, or moving cash around multiple accounts, splitting it and transferring to a range beneficiaries. The aim of this process is, after several repetitions, for the cash to appear legitimate.

3. Integration

Finally, the through the Integration stage, money is returned to criminals legitimately. The illicit funds are now 'clean' and can be used for any purpose.

Defending Insurance Businesses

With money laundering in the insurance industry on the **rise**, the UK has recently seen a record number of Suspicious Activity Reports ('SARS') and Defence Against Money Laundering ('DAML') reports. The DAML submissions saw increases in volume in every month, with the highest number of cases submitted in any one month in January 2020, representing a **116% increase** on the total January 2019 submissions (source National Crime Agency).

UK Insurance Businesses need to operate a robust series of controls, processes and measures to protect themselves from involvement in financial crime and to avoid compliance violations as well as remaining aware of current regulations to avoid non-compliance penalties. In the event of non-compliance, Her Majesty's Revenue and Customs (**HMRC**) can impose unlimited fines both corporately and personally, and in more serious cases,

14 Years

Imprisonment

This can apply to anyone

HMRC will also publish details of your business if you do not comply with the regulations, which can cause significant reputational damage.

The action that HMRC takes in the event of non-compliance will depend on the seriousness and potential impact of the failures identified and is the same process for all types of insurance firms:

- reason for non-compliance
- seriousness of the offence
- compliance history of the business
- relative size of the business
- benefits received
- amount exposed to money laundering activities

However, you will be protected from penalties and prosecution if you can show you have followed the HMRC's Money Laundering Regulations guidance. The HMRC will also allow reductions to the penalty when you make an unprompted disclosure that you have breached the regulations.

The FCA's Message

This year the FCA has reinforced its role in policing firm's AML systems and controls and will not hesitate to use its criminal, civil and regulatory powers where appropriate. Furthermore, it stresses that systems and controls must be commensurate with the AML risks faced by the firm.

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Two of the FCA's biggest sanctions in the last 12 months related to failures in financial crime and AML risks and the FCA recently commenced its first criminal prosecution against a regulated firm.

What you need to know

Insurance firms must put in place an AML/CFT compliance program that includes customer and business due diligence and transaction monitoring measures in line with their regulatory obligations. Their AML program should also screen for adverse media stories, politically exposed person (PEP) status and sanctions lists.

1. Complete KYC and KYB

Insurance firms need to complete due diligence on their customers and trading partners for every insurance policy transacted. The amount of due diligence must be based on a risk assessment.

2. Carry out enhanced due diligence if high-risk

These might include:

- There are relevant transactions between parties based in high-risk third countries.
- The customer is the beneficiary of a life insurance policy.
- The customer is a third-country national seeking residence rights or citizenship in exchange for transfers of capital, purchase of a property, governments bonds or investment in corporate entities.
- Non face-to-face business relationships or transactions without certain safeguards, for example, as set out in regulation 28 (19) concerning electronic identification processes.
- Transactions related to oil, arms, precious metals, tobacco products, cultural artefacts, ivory, or other items related to protected species, or archaeological, historical, cultural, and religious significance, or of rare scientific value.

3. Report discrepancies

Following due diligence, as soon as a firm 'knows' or 'suspects' that a person is engaged in money laundering it must submit a SAR. By submitting a SAR to the NCA, you will be complying with any potential obligations you have under the Proceeds of Crime Act 2002 (POCA).

Responsibilities

The board of directors is responsible for the adequate and effective execution of the company's AML and Combating the Financing of Terrorism (CFT) programs. Accordingly, the board of directors is responsible for establishing the company's AML compliance program and ensuring that the risk management, monitoring, and other activities are carried out in a coordinated and effective manner.

An individual must be appointed as a MRLO to oversee their firm's AML compliance program. The MLRO should have sufficient authority and knowledge of money laundering risks to carry out their duties effectively will have to advise senior management about their firm's risk of exposure to money laundering – and how to manage that risk.

The FCA points out that a person appointed as MLRO should have sufficient authority to carry out their duties effectively. The duties of the MLRO may involve serious legal consequences that result in a civil and criminal action.

Firms should ensure their employees have the knowledge and resources they need by implementing an ongoing training schedule and anticipating upcoming regulatory changes.

Automation: A Helping Hand

Businesses operating within regulated industries face continually evolving challenges, from their regulatory and AML responsibilities alongside progressively competitive commercial tests. It is widely accepted that AML compliance costs for insurance firms is continuing to rise. In the UK cost equates to an annual spend of £28.7 billion and is expected to rise to over £30 billion by 2023, which will mean the cost of complying is not far behind the cost of the crime itself!

For insurance businesses, regardless of size, AML compliance is as much about managing cost as managing risk. The RegTech industry has steadily established itself as an effective solution for driving operational efficiencies and facilitating business transactions between counterparties.

By 2023 AML compliance costs for insurance firms are expected to rise over

£30 billion

It's Not Just About Banking

In the insurance market RegTech has become an integral tool for firms to undertake due diligence and oversight of their trading counterparties and forms the bedrock of a robust governance and control framework. However, market research carried out by REG Technologies in 2020 showed:

Less than half of all brokers, insurers and MGAs have constantly automated processes in place

36% of brokers and intermediaries only carry out due diligence checks annually

36%

A worrying 7% of firms don't carry out reviews of their trading partners at all. (Source REG 'Building a Faster, Smarter, Safer Market).

7%

"AML systems and controls must be focussed explicitly on the activating purpose and function of those controls, to ensure the system is not just a bureaucratic process and to ensure it cannot be gamed."

Mark Steward
FCA Executive Director of Enforcement and Market Oversight

"A risk-based approach means a focus on outputs. Firms that apply a risk-based approach to anti-money laundering (AML) will focus AML resources where they will have the biggest impact."

Financial Conduct Authority 29th June 2021