

**“SHOW ME THE MONEY”:
ANTI-MONEY LAUNDERING PROGRAM REQUIREMENTS**

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Under regulations issued last fall by the U.S. Treasury’s Financial Crimes Enforcement Network (“FinCEN”), life insurers were required to implement written anti-money laundering (“AML”) programs and begin reporting suspicious transactions to federal authorities by May 2, 2006.¹ Although the compliance deadline has come and gone, many insurers continue to work to implement some aspects of their AML programs—most notably, AML training for agents and brokers. Others are looking for ways to fine tune their AML programs so as to keep pace with evolving industry standards concerning what constitutes an effective and reasonable program. This article examines some of the ways in which insurers have sought to comply with the new AML requirements and the various ways in which insurers continue to adjust their AML programs.

Background

The AML regulations for insurers, and related regulations requiring insurers to report suspicious transactions, have their origin in amendments to the Bank Secrecy Act enacted by Congress shortly after 9/11 under the USA PATRIOT Act (the “Patriot Act”).² The amendments required a broad range of financial institutions, including insurers, to establish written AML programs and gave the Secretary of the Treasury authority to establish new suspicious activity reporting and “know your customer” requirements for such institutions.³ Beginning in 2001, FinCEN began issuing new AML and AML-related requirements for a variety of financial institutions, including securities broker-dealers,⁴ mutual funds, and money services businesses. Early on in this process, however, FinCEN suspended the application of AML and related requirements to insurers until it could fully consider how to apply such requirements to the insurance industry.⁵

Finally, in November 2005, FinCEN issued regulations requiring life insurers to implement written AML programs and file Suspicious Activity Reports (“SARs”) beginning May 2, 2006.⁶ The AML and SAR regulations only apply to “covered products,” which are defined as (1) permanent life insurance policies, other than group policies; (2) annuity contracts, other than group annuities, and (3) any other insurance product with features of cash value or investment.⁷ After the regulations were issued, FinCEN clarified in guidance that the catch-all category for “any other insurance product with features of cash value or investment” is not intended to apply to group life products or group annuities, but rather meant to cover any new products with features of cash value or investment that the industry might develop and that are particularly vulnerable to money laundering.⁸ FinCEN has not issued a separate “know your customer” regulation for insurers, as it has for certain other types of financial institutions. This does not mean that insurers are free to ignore identity verification of customers entirely. Instead, as discussed below, insurers must collect enough information about their customers to allow implementation of an effective AML program.

FinCEN limited the AML and SAR regulations to products with features of cash value or investment because these were the only insurance products deemed to present any significant risk of being used to launder money.⁹ Money laundering involving an individual whole life policy might be accomplished, for example, by the purchase of a large single-premium policy followed by return of the policy during the free look period or early surrender for cash value.

The Regulatory Break-In Period

Like most new regulatory schemes, the AML (and SAR) regulations have gone through (and continue to experience) a “break-in period” during which the regulated community and regulators work out what the new standards mean in practical effect. In the case of AML, this adjustment is complicated by the fact that the particulars of the AML program an insurer must adopt depends on its assessment of the money laundering risks it faces given the nature of its operations.¹⁰ Thus, each insurer has a certain amount of discretion to determine what AML measures are reasonable for its business. This aspect of the regulations brings welcome flexibility to the regulatory scheme, but it also creates a degree of uncertainty about what constitutes a compliant AML program, especially in these early days of implementation. To some extent, what constitutes a “reasonable” program depends on what other insurers in like

circumstances have decided to do. Yet because all insurers are new to the regulatory environment, the standard approach is still a little fluid.

One solution is to look to what other financial institutions that already have adopted AML programs have done under situations presenting similar risks. Banks, as well as insurance producers who are licensed securities broker-dealers so that they may sell variable life and annuity products, have been subject to AML and related requirements for some time now.¹¹ Although not all AML standards that apply to banks and broker-dealers are necessarily appropriate for insurers, the experience developed in this area provides a useful starting point for assessing what constitutes a reasonable AML program for any given insurer.¹² International AML standards and guidance for insurers also are useful points of reference.¹³

Varying Approaches to Implementing an AML Program

Rather than reviewing each required element of an AML program, this article considers two of the less tractable requirements and various industry responses to them.¹⁴

Collecting Customer Information

As mentioned above, FinCEN has not issued separate “know your customer” regulations for insurers as it has done for other types of financial institutions. Rather, the AML regulations for insurers simply state that an insurer must implement AML policies and procedures that include provisions for “obtaining all relevant customer-related information necessary for an effective anti-money laundering program.”¹⁵ Similarly, the SAR regulations provide that “an insurance company shall establish and implement policies and procedures reasonably designed to obtain customer-related information necessary to detect suspicious activity from all relevant sources...”¹⁶ These very general standards fall far short of the more prescriptive “know your customer” requirements applicable to other types of financial institutions, such as broker-dealers, which require the establishment of procedures for verifying the identity of each customer—for example, by inspecting a government-issued photo ID—and the collection of certain minimum information about customers, such as a residential or business street address (not a P.O. Box number) and a Social Security number or other official identification number.¹⁷

The question for insurers, is, “How much customer information must be collected to implement an effective AML program and satisfy SAR requirements?” The answer depends on the risk of money laundering presented by the insurer’s operations. Before getting into that issue, however, one must consider another question—namely, “Who is the customer?” Both the AML and the SAR regulations require insurers to collect information about “customers,” but the term is not defined. A customer conceivably could be anyone with an interest in an insurance contract, including the contract owner, the insured or annuitant and beneficiaries. Nevertheless, because the contract owner has control over the flow of dollars into and out of the product (and therefore the ability to use the product to launder money), information about the contract owner is an essential component of an effective AML program. Thus, it seems to make most sense to focus information collection and verification efforts on the contract owner. This approach is consistent with international AML standards for insurers, which treat the contract owner as the “customer” for identity verification purposes.¹⁸

So how much customer information is enough? In the case of high face value permanent life and annuity products, which present a higher risk of being used to launder money, fairly extensive customer verification procedures might be appropriate, including inspecting a photo ID or verifying the contract owner’s identity through “nondocumentary” methods such as comparing information provided by the customer with information available on a consumer report. On the other hand, an insurer that markets lower face value products—for example, policies designed to pay for a specific personal expense such as a child’s tuition or funeral expenses—might adopt less extensive procedures for collecting customer information. In the case of these and other products with a low risk of money laundering, it might be sufficient simply to require producers in the field to form a reasonable belief that they know the identity of new contract owners—for example, by examining a driver’s license or similar photo ID, visiting with the customer at the customer’s residence or place of business or having personal knowledge of the customer’s identity.

Under the risk-based approach to establishing an AML program adopted by the regulations, varying approaches to collecting and verifying customer information clearly are appropriate based on the risk of money laundering

presented by an insurer's products. It seems unlikely, however, that an effective AML program could exclude any customer identity verification procedures entirely. Even in the lowest risk situations, insurers likely need to gather and verify basic information about new contract owners to implement a reasonable and effective AML program.

Training Agents and Brokers

One of the most difficult aspects of the AML regulations from a practical perspective is the requirement that insurers integrate agents and brokers into their AML programs. Rather than require agent and brokers to develop their own AML programs, FinCEN made a decision to make it the duty of insurers to verify that the producers with whom they do business follow reasonable AML policies and procedures. Obviously, by placing the compliance burden on insurers, FinCEN greatly simplifies the task of enforcing the regulations and likely achieves wider compliance among agents and brokers.

One of the aspects of integrating agents and brokers into an insurer's AML program is providing "ongoing [AML] training" for such persons.¹⁹ Under the regulations, an insurer may satisfy this requirement "by directly training such persons or verifying that persons have received training by another insurance company or by a competent third party with respect to the covered products offered by the insurance company."²⁰ As with other aspects of AML, approaches to implementing this requirement vary among insurers, depending on the risk profile of their products. On one end of the spectrum, insurers have provided in-house or commercial third-party AML training for producers on the Internet or through classroom instruction. Insurers adopting this approach also have permitted producers to certify that they completed similar training sponsored by another insurer or financial institution subject to AML requirements. Some insurers have accepted AML training that qualifies for continuing education credit on the theory that such training has been reviewed and deemed adequate by state regulators or a creditable self-regulatory organization such as the National Association of Securities Dealers. Guidance issued by FinCEN makes it clear that "mere certification" of a producer's completion of a training program is not sufficient to comply with the AML regulations.²¹ Instead, FinCEN states that "evaluation of the substance of the training is essential."²² The guidance acknowledges, however, that an insurer's evaluation of a training program may be less stringent if it is sponsored by another insurer or financial institution that is subject to AML requirements.²³

On the other end of the spectrum, some insurers offering products with a very low risk of money laundering have limited their training to circulating written AML compliance guidelines to appointed producers and requiring each producer to certify that he or she has reviewed the guidelines and will follow them. Obviously, this is a minimal approach, but it may be acceptable in circumstances where the risk of money laundering is extremely low.

Many insurers had difficulty verifying that all of their agents and brokers had received appropriate AML training by the May 2, 2006 compliance deadline. In guidance on the AML regulations, FinCEN acknowledged that some insurers may require additional time to train their producers and stated that so long as an insurer had adopted a written AML program by the May 2 deadline with reasonable plans to train producers, it would be considered compliant.²⁴

Conclusion

Like most new regulatory schemes, the AML and SAR regulations for insurers require an adjustment period during which the regulated community and regulators settle on what must be done in practice to implement the new requirements. In the case of AML, this process is complicated somewhat by the fact that the requirements for implementing an AML program are expressly risk based, leaving insurers with considerable discretion to determine what is a reasonable compliance program given the risk of money laundering presented by their operations. It is still early in the evolutionary cycle for AML compliance by insurers. Insurers continue to adjust their AML programs as they encounter practical issues in the field, evaluate measures adopted by their competitors in similar market segments, and seek to "true up" their programs to conform with emerging industry standards.

Endnotes

¹ Financial Crimes Enforcement Network, *Amendment to Bank Secrecy Act Regulations—Anti-Money Laundering Programs for Insurance Companies*, 70 Fed. Reg. 66754 (Nov. 3, 2005) (regulations codified at 31 CFR § 103.137);

Financial Crimes Enforcement Network, *Amendment to Bank Secrecy Act Regulations—Requirement That Insurance Companies Report Suspicious Transactions*, 70 *Fed. Reg.* 66761 (Nov. 3, 2005) (regulations codified at 31 CFR § 103.16).

² Pub. Law No. 107-56.

³ Patriot Act, §§ 326, 351, 352.

⁴ Compliance for securities broker-dealers, which includes producers marketing variable life and annuity products, is implemented through the National Association of Securities Dealers.

⁵ 67 *Fed. Reg.* 21109, 21111 - 21112 (April 29, 2002).

⁶ 70 *Fed. Reg.* 66754 (Nov. 3 2005); 70 *Fed. Reg.* 66761 (Nov. 3, 2005).

⁷ 31 CFR §§ 103.16(a)(4), 103.137(a)(4). A “permanent life insurance policy” means “an agreement that contains a cash value or investment element and that obligates the insurer to indemnify or to confer a benefit upon the insured or beneficiary to the agreement contingent on the death of the insured.” 31 CFR §§ 103.16(a)(10), 102.137(a)(10). Essentially, a “permanent life insurance policy” is a whole life or universal life policy or rider. A term life product with an option to convert to whole or universal life also could constitute a covered product, although the risk that such a policy could be used for money laundering is remote.

⁸ FinCEN, *Frequently Asked Questions: Anti-Money Laundering Program and Suspicious Activity Reporting Requirements for Insurance Companies*, at p. 1, FIN-2006-G010 (May 31, 2006) (supplementing FAQ guidance issued by FinCEN in November 2005).

⁹ 70 *Fed. Reg.* at 66757.

¹⁰ 31 CFR § 103.137(c)(1).

¹¹ Since 1987, all federally insured depository institutions and credit unions have been required to have AML programs. *See* 12 CFR §§ 21.21, 208.63, 326.8, 563.177, 748.2. Broker-dealers have been required to have AML programs since 2002. *See* Securities and Exchange Act Release No. 45789.

¹² *See, e.g.*, Federal Financial Institutions Examination Council, *Bank Secrecy Act Anti-Money Laundering Manual*, (June 2005); National Association of Securities Dealers, *Notices to Members* 06-07, 03-34, 02-80, 02-78, 02-50, 02-47, 02-21, and 01-67.

¹³ *See, e.g.*, International Association of Insurance Supervisors, *Guidance Paper on Anti-Money Laundering and the Combating of Terrorist Financing* (Oct. 2004); Financial Action Task Force on Money Laundering, *Forty Recommendations on Money Laundering*.

¹⁴ For an overview of the AML and SAR requirements for insurers, *see* Holahan, *Life Insurers Must Comply with New Anti-Money Laundering Rules*, *ABIA Insurance Weekly* (March 21, 2006).

¹⁵ 31 CFR § 103.137(c)(1).

¹⁶ 31 CFR § 103.16(b)(3)(i).

¹⁷ 31 CFR § 103.35(b).

¹⁸ *See* International Association of Insurance Supervisors, *Guidance Paper on Anti-Money Laundering and the Combating of Terrorist Financing*, n. 9 (Oct. 2004).

¹⁹ 31 CFR § 103.137(b)(3).

²⁰ *Id.*

²¹ FinCEN, *Anti-Money Laundering Program and Suspicious Activity Reporting Requirements for Insurance Companies: Frequently Asked Questions*, at p. 6 (Nov. 2005).

²² *Id.*

²³ *Id.*

²⁴ FinCEN, *Frequently Asked Questions: Anti-Money Laundering Program and Suspicious Activity Reporting Requirements for Insurance Companies*, at pp. 2-3, FIN-2006-G010 (May 31, 2006) (supplementing FAQ guidance issued by FinCEN in November 2005).