What Insurance Agents and Brokers Should Expect under the New Anti-Money Laundering Regulations for Life Insurance Companies

The USA PATRIOT Act includes provisions intended to prevent the financial services industry, including the insurance sector, from being used for money laundering and terrorist financing by criminals and terrorists. The Act requires insurance companies to establish anti-money laundering (AML) programs that comply with minimum standards developed by the Department of the Treasury. Regulations issued by the Treasury Department and its Financial Crimes Enforcement Network (FinCEN) establish minimum requirements for insurance company anti-money laundering programs and require insurers to report suspicious transactions.

Although insurance agents and brokers are not required to have their own anti-money laundering programs, the Treasury Department and FinCEN have stated that insurance agents and brokers are expected to play an important role in implementation of these programs by insurers. ACLI's member insurance companies are mindful of the burden that inconsistent or conflicting programs could impose on agents and brokers, and are cooperating on various means of avoiding any undue burden, while assuring the effectiveness of the industry's efforts to combat money laundering.

This document has been prepared by the American Council of Life Insurers (ACLI) in conjunction with the National Association of Insurance and Financial Advisors (NAIFA) and is intended to provide agents and brokers with a brief description of money laundering and terrorist financing and the ways in which the insurance industry might be used to engage in such activities. In addition, it serves as an introduction to the requirements imposed by the Treasury Department regulations, and some of the means by which brokers and agents may be integrated into insurers' AML programs.

What is Money Laundering and Terrorist Financing?

Money laundering. Money laundering is a varied and often complicated process that can, but does not always, involve cash transactions. Illegally-obtained money is filtered through a series of transactions that eventually make the money appear to be obtained from “clean”, or legal, activities. The money laundering process has been described as having three phases that often overlap:

> Placement—Injecting ill-gotten proceeds, including cash, into the financial system through transactions such as bank deposits or the purchase of certain insurance products
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> Layering—Separating illicit proceeds from their criminal source through complex financial transactions
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> Integration—Putting the proceeds back into circulation in the economy, with the appearance of legality.

Terrorist financing. Terrorist financing involves the use of money, which may be lawfully obtained, to fund illegal activities. Because the transactions often have a legitimate origin and can often involve small amounts of money, terrorist financing can be more difficult to identify than money-laundering activities, although an effective anti-money laundering program can help prevent the use of funds for terrorism activities.

What Responsibilities Will Agents and Brokers Have Under the New Rules?

The new insurance regulations do not require insurance agents and brokers to establish anti-money laundering programs or to report suspicious transactions themselves. However, FinCEN has made clear that life insurance agents and brokers will have an important role to play in insurance companies’ anti-money laundering programs because they have direct contact with customers and are thus often in the best position to gather information and detect suspicious activity. To assure that insurance companies and their distribution partners collaborate in preventing money laundering, the new rules require life insurance companies to integrate agents and brokers into their anti-money laundering programs and to monitor the agents’ compliance with the programs. The preamble to the rules states that if efforts to integrate agents into insurance company programs are ineffective, FinCEN may reconsider its decision not to require agents and brokers to establish their own programs. The regulations are effective on May 2, 2006. On that date, insurance company programs must be up and running.

There are two new regulations requiring collaboration between insurance companies and their agents or brokers. In general, the first requires each insurance company to develop and implement a written anti-money laundering program, applicable to “covered products,” that is reasonably designed to prevent the insurance company from being used to facilitate money laundering or the financing of terrorist activities. These programs must (a) include risk-based policies, procedures and controls that, among other things, “integrat[e]” the company’s insurance agents and insurance brokers into its anti-money laundering program,” (b) designate a compliance officer responsible for the program, (c) provide for ongoing training of individuals, including agents and brokers, with responsibilities under the program, and (d) provide for independent testing of the program, including testing with respect to compliance of agents and brokers. The second rule requires insurance companies to report "suspicious activities" and to establish procedures to obtain information from agents and brokers, among others, necessary to detect and report those transactions.

Each insurance company is required to establish an AML program that is "risk-based," which means that each company's program must address the money laundering risks arising from the company's particular product mix and unique business practices.

"Covered Products." The rules are not applicable to all insurance products. Rather, the Treasury Department identified categories of "covered products" that in its judgment presented sufficient AML risk to justify regulation. "Covered products" are defined to include:

- A permanent life insurance policy, other than a group life insurance policy;
- An annuity contract, other than a group annuity contract; or
- Any other insurance product with features of cash value or investment.

Accordingly, property-casualty coverage, health insurance, and term life insurance, among other kinds of products, need not be included in an insurance company's AML program. Insurance companies may offer guidance on which of their products are covered under their programs.

Customer Information. The new rules require insurance companies to collect customer information from agents and brokers, among other sources, to support their anti-money laundering programs and to detect and report suspicious transactions. FinCEN has made clear that insurance agents and brokers have a crucial role to play in this area:

> [I]nsurance agents and brokers are an integral part of the insurance industry due to their contact with customers. Insurance agents and brokers typically are involved in sales operations and are therefore in direct contact with customers. As a result, the agent or broker will often be in a critical position of knowledge as to the source of investment assets, the nature of the client, and the objectives for which the insurance products are being purchased.

Because each company's program must be risk-based, agents and brokers should expect to collect and retain information needed to assess the risk associated with particular business – in particular, to identify customers in high-risk businesses or high-risk geographic locations, or those using products or services that may be more susceptible to abuse in money laundering activity.

Efforts will be made to assure that agents and brokers who sell insurance products through broker-dealers that have their own anti-money laundering programs will not be subject to inconsistent insurance company programs. These registered representatives will likely experience little, if any, change to their current customer due diligence requirements with respect to sales of variable products.

Methods of Payment. Certain forms of payment – including cash, money orders, traveler's checks, and bank checks – can be used in the placement phase of a money laundering scheme. To manage this risk, companies may set limits on the forms of payments that will be accepted and the amounts acceptable for some of them. The goal is to reduce the chances that the insurance business will be involved in money laundering, without excluding forms of payment with a legitimate business purpose. Because agents and brokers often collect at least the first premium due under a policy, they may be called upon to inform customers of these standards and enforce them.

Suspicious Transactions. Insurance companies will be developing controls and procedures to identify and report suspicious transactions – in general transactions aggregating $5,000 or more that a company has reason to suspect (i) involve funds derived from illegal activity or are intended to hide funds derived from illegal activity, (ii) are designed to evade reporting requirements imposed by Federal law, (iii) have no apparent lawful purpose or are not the sort in which a particular customer would be expected to engage, or (iv) that involve the use of the insurance company to facilitate criminal activity. Significantly, reportable transactions are not limited to a narrow definition of money laundering. They include any effort to involve an insurance company in illegal activity, and may even include lawful transactions that are atypical for the customer involved and for which there is no reasonable explanation.

Although insurance agents and brokers are not independently required to report suspicious transactions, the regulation makes clear that agents and brokers are expected to work with insurance companies in identifying suspicious transactions that the company must report:

> An insurance company is responsible for reporting suspicious transactions conducted through its insurance agents and brokers. Accordingly, 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, including from its insurance agents and brokers…

Agents and brokers are often in the best position to detect suspicious activity – for instance, customers who are resistant to requests for information, who are indifferent to the features of a product, except for withdrawal rights, or who seek products inconsistent with their apparent needs. Companies are likely to notify agents of "red flags" that should be called to the insurance company's attention.

Under federal law, insurance agents and brokers, as well as insurance companies, are protected from liability to customers for disclosing possible criminal activity to their insurance companies, law enforcement, and certain government supervisory agencies. Suspicious Activity Reports and the fact that they have been filed must be kept confidential. In particular, customers cannot be notified that a suspicious activity has been reported.

Training for Agents and Brokers. The new regulations require companies to train their agents and brokers regarding their responsibilities under the company's anti-money laundering program. The rules state that the company may satisfy this requirement by directly training its agents and brokers or by verifying that its agents and brokers have received adequate training through another insurance company or by a competent third-party. These programs are expected to be tailored to the needs of agents and brokers and to include training on identifying suspicious customer behavior and transactions as well as on procedures to report suspicious activities to the company.

Testing the Effectiveness of the Anti-Money Laundering Program. An insurance company is required to conduct independent testing as to the effectiveness of its anti-money laundering program, including the compliance of its agents and brokers. The Internal Revenue Service will examine insurance companies on the adequacy and effectiveness of their anti-money laundering programs.

Contractual Arrangements With Agents and Brokers. FinCEN contemplates that companies will be expected to use their contractual relationships to require agents and brokers to provide them with information that may be useful for identifying potential suspicious activity

The contractual responsibilities of agents and brokers with respect to anti-money laundering programs will likely be similar the current responsibilities agents and brokers undertake in connection with company customer identification and anti-fraud procedures. Insurers already have numerous compliance and best practices guidelines that both captive and independent agents and brokers follow in order to continue doing business with them. Insurers also require very extensive information-gathering by many of their agents and brokers for underwriting purposes. It is expected that many insurance companies will adopt the same structural model for their anti-money laundering programs.

Conclusion

Insurance companies and their agents and brokers are proud of the products and services that they offer. Even before being tasked by the Congress with the responsibilities set forth in the new AML rules, insurance companies and their agents and brokers took serious efforts to prevent, identify, and report suspicious financial transactions. By continuing to make it difficult for criminals to use insurance products for illegal purposes, the life insurance industry and the economy in which it operates, both domestic and foreign, are strengthened.