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Continuing Education

Anti Money Laundering

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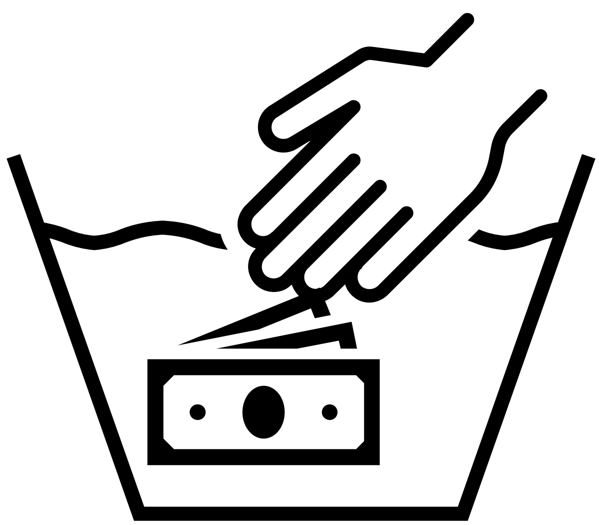

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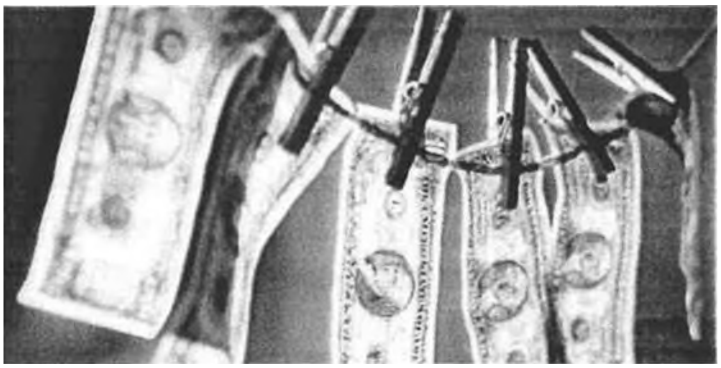
Anti-Money Laundering

Table of Contents

Anti-Money Laundering

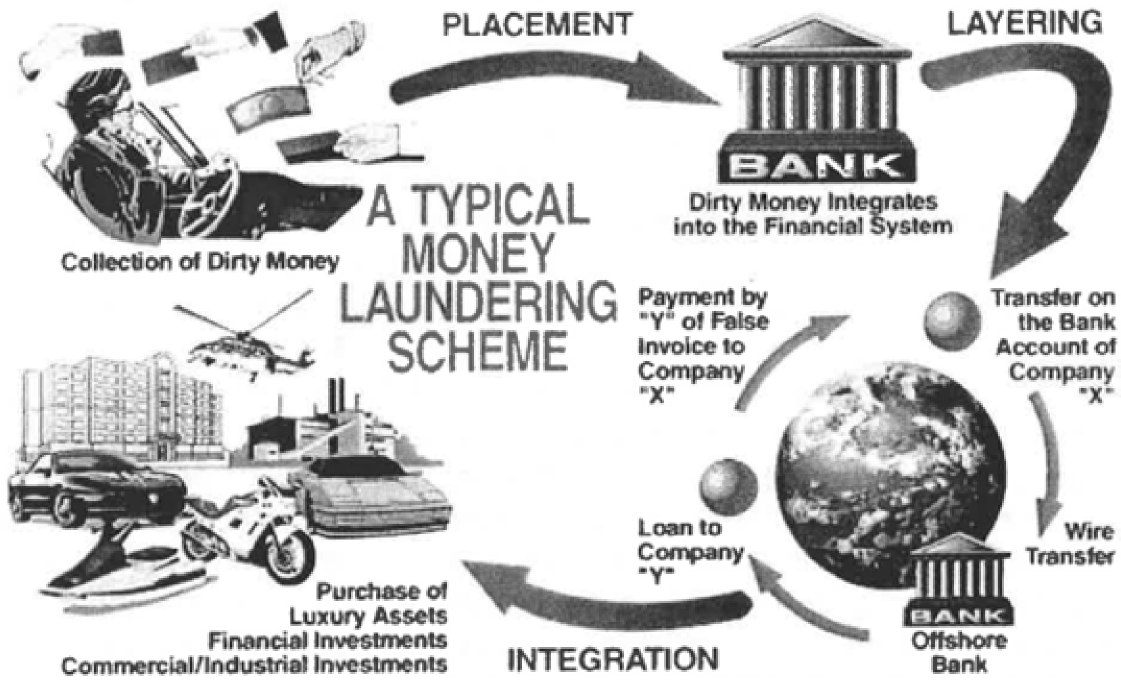
I. Introduction

Anti-money laundering ("AML") is a term mainly used in the financial and legal entities to prevent or report controls that require financial institutions and other regulated industries to describe the legal money laundering activities. Anti-money laundering guidelines came into prominence globally after the September 11, 2001, attacks and the subsequent enactment of the USA PATRIOT Act.



Today, all financial institutions globally are required to monitor, investigate and report transactions of a suspicious nature to the financial intelligence unit of the central bank in the respective country. For example, a bank must perform due diligence by having proof of a customer's identity and that the use, source and destination of funds do not involve money laundering. United States federal law related to money laundering is implemented under the Bank Secrecy Act of 1970 as amended by anti-money laundering acts up to the present. Many people have confused Anti-Money Laundering ("AML") with Anti-Terrorist Financing ("ATF"). Under the Bank Secrecy Act of USA, Money Laundering and Terrorist Financing are classified into two different categories when financial institutions file Suspicious Activities Reports ("SAR") to Financial Crimes Enforcement Network ("FinCEN") which is a US government agency. To effectively implement AML and ATF measures, The US government encourages financial institutions to work together for AML and ATF purposes in accordance with Section 314(b) of the USA PATRIOT Act. However, since financial institutions are required by law to protect the privacy of their clients, section 314(b) cooperation has not been generally adopted by financial institutions. To overcome this obstacle, the United Crimes Elimination Network (UCEN) has been established by AML and ATF professionals to achieve this global cooperation goal in compliance with the privacy laws of most countries.

An entire industry has developed around providing software to analyze transactions in an attempt to identify transactions or patterns of transactions that may constitute illegal financial activity. Financial institutions face penalties for failing to properly file CTR (Cash Transaction Report)and SAR (Suspicious Activity Report) reports, including heavy fines and regulatory



restrictions, even to the point of charter revocation. These software applications effectively monitor bank customer transactions on a daily basis and, using customer historical information and account profile, provide a “whole picture” to the bank management. Transaction monitoring can include cash deposits and withdrawals, wire transfers, credit card activity, cheques (checks), share (securities) dealing and ACH activity. In the bank circles, these applications are known as “BSA software” or “AML software”.

Different standards exist in different countries and dependent on the activity demand, different action. For example; in the US a deposit of US$10,000 or more requires a CTR, in Europe it is US$15,000, and in Switzerland it is CHF 25,000 in many countries there is no CTR requirement. The suspicion of AML activity in the US requires the submittance of a SAR, in Switzerland a SAR will only get filed if that activity can be proved. These two examples demonstrate why in the USA thousands of SARs are filed daily. In Switzerland it is more like one or two a year.

Money laundering is the processing of the proceeds of crime to disguise their illegal origin. Sometimes the funds did not originate from crime but the individuals want to conceal fund origins since they will be used for terrorist activities (the parties do not want to be identified in this case). Insurers and agents have always had responsibilities regarding the processing of policy applications and ethical requirements. Now, they have additional responsibilities related to anti-money laundering and terrorist activities as a result of changes in the Bank Secrecy Act and the passing of the USA PATRIOT Act. This will be a new frontier for the majority of those associated with the insurance industry. Agents and insurers have traditionally felt that they were immune from such activity. Today we realize that cash value life products offer an excellent method of money laundering.

This continuing education course is designed to educate the agents and brokers who are likely to be the first individuals to have contact with criminals or members of terrorist groups wishing to launder money or conceal the origins of their funds. The insurance sector includes insurers, reinsurance companies, and their intermediaries.

Intermediaries relates to agents, brokers or others who would be performing services on behalf of an insurer. Since agents and brokers have not routinely received education in such matters but must now do so, this course has been designed to fill that need.

The ability to use an insurance product for money laundering depends upon specific factors, including the complexity and terms of the policy, distribution options, and contract law. The types of contracts most vulnerable will have cash values that can be easily accessed. Any fees or premature surrender charges are seldom a concern since they consider such fees or penalties to be an acceptable business expense. The policies themselves may be merely one part of a sophisticated web of complex transactions with their origins elsewhere in the financial system.

Other types of insurance may also be involved in money laundering activities. Policies may be taken out to insure a building that will be purposely torched, for example. The assets acquired by money launderers may be insured, with premiums paid from illicit funds. An example of this would be the insurance placed on a luxury automobile.

Agents and brokers play an important role in anti-money laundering activities. This is true of both independent and captive agents. It is through agents and brokers that terrorists and criminals purchase policies. Therefore, it is the agents and brokers who are most likely to initially recognize suspicious actions or goals. The Financial Action Task Force (FATF) Recommendations allow insurers, under strict conditions, to rely on customer due diligence carried out by their intermediaries. Those who wish to launder their illicit funds will seek out agents and brokers who seem unaware of, or do not seem concerned with, essential anti-money laundering procedures.

The ultimate responsibility for preventing money laundering falls on insurers, but they will need to rely on their intermediaries to some degree since they are in the best position to recognize unusual or suspicious behavior. In order for intermediaries to understand their client due diligence responsibilities insurers must develop a clear, written, risk-based approach to both accepting new clients and reviewing existing ones. This is likely to include developing client profiles.

Obviously each of us should be concerned with how terrorist activities are financed. Their activities can affect each American in very personal ways, as demonstrated in the September 11th attack. Even if the insurers we contract with require no particular anti-money laundering procedures while marketing their products, agents and brokers owe it to themselves and their families to be aware of how terrorists finance their activities, including money laundering. Each agent and broker must be alert to suspicious activity and follow up on any questionable transactions, forwarding the information to the proper authorities.

II. Money Laundering Basics

Money laundering, at its simplest, is the act of making money that comes from Source A look like it comes from Source B. In practice, criminals are trying to disguise the origins of money obtained through illegal activities so it looks like it was obtained from legal sources. Otherwise, they can't use the money because it would connect them to the criminal activity, and law-enforcement officials would seize it.

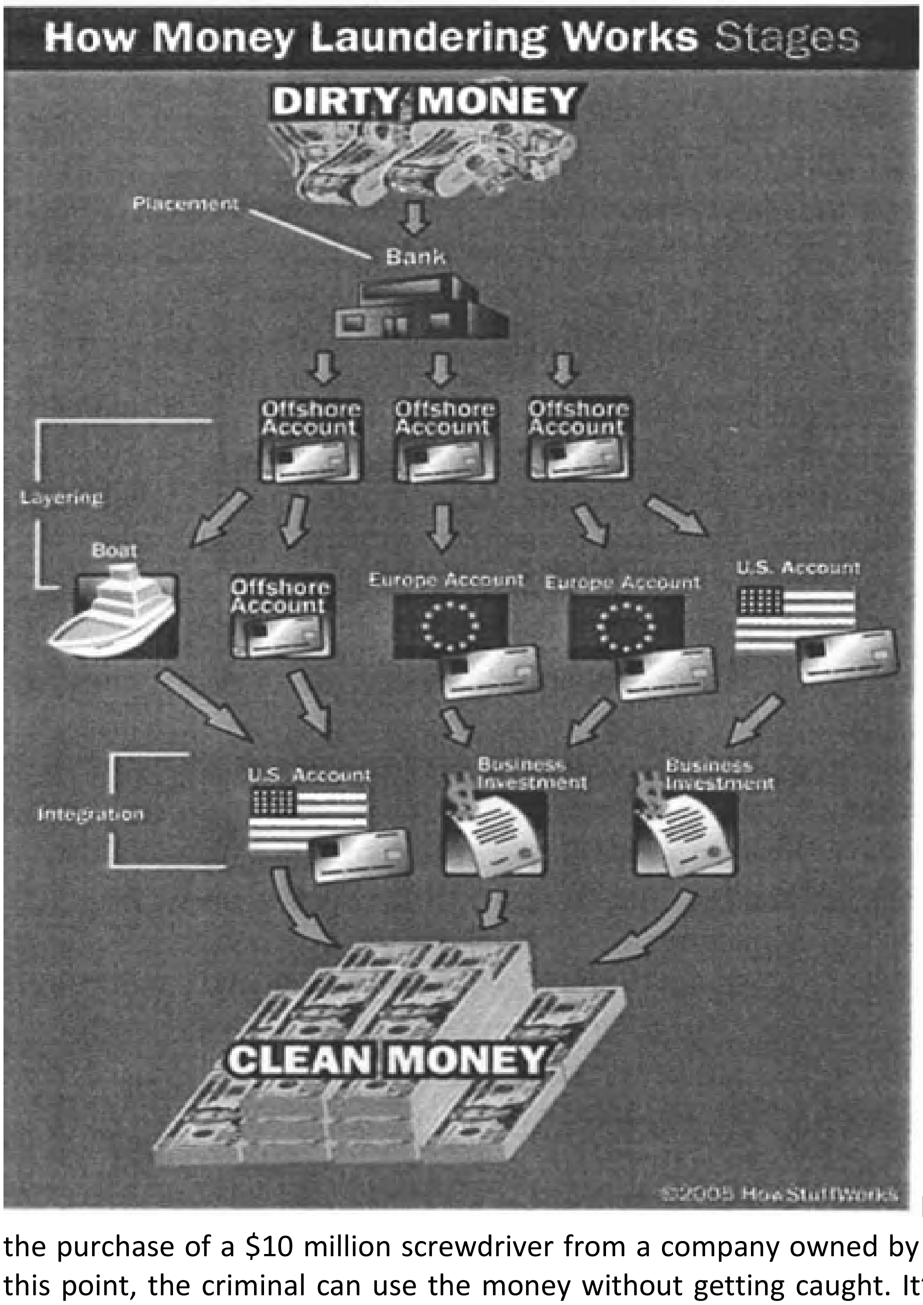
The most common types of criminals who need to launder money are drug traffickers, embezzlers, corrupt politicians and public officials, mobsters, terrorists, and con artists. Drug traffickers are in serious need of good laundering systems because they deal almost exclusively in cash, which causes all sorts of logistics problems. Not only does cash draw the attention of law-enforcement officials, but it's also really heavy. Cocaine that's worth $1 million on the street weighs about 44 pounds (20 kg), while a stash of U.S. dollars worth $1 million weighs about 256 pounds (116 kg).

The basic money laundering process has three steps:

1. **Placement** - At this stage, the launderer inserts the dirty money into a legitimate financial institution. This is often in the form of cash bank deposits. This is the riskiest stage of the laundering process because large amounts of cash are pretty conspicuous, and banks are required to report high-value transactions.
2. **Layering** - Layering involves sending the money through various financial transactions to change its form and make it difficult to follow. Layering may consist of several bank-to-bank transfers, wire transfers between different accounts in different names in different countries, making deposits and withdrawals to continually vary the amount of money in

the accounts, changing the money's currency, and purchasing high-value items (boats, houses, cars, diamonds) to change the form of the money. This is the most complex step in any laundering scheme, and it's all about making the original dirty money as hard to trace as possible.

3. **Integration** - At the integration stage, the money re-enters the mainstream economy in legitimate-looking form -- it appears to come from a legal transaction. This may involve a final bank transfer into the account of a local business in which the launderer is "investing" in exchange for a cut of the profits, the sale of a yacht bought during the



layering stage or the purchase of a $10 million screwdriver from a company owned by the launderer. At this point, the criminal can use the money without getting caught. It's very difficult to catch a launderer during the integration stage if there is no documentation during the previous stages.

Money laundering is a crucial step in the success of drug trafficking and terrorist activities, not to mention white collar crime, and there are countless organizations trying to get a handle on the problem. In the United States, the Department of Justice, the State Department, the Federal Bureau of Investigation, the Internal Revenue Service and the Drug Enforcement Agency all have divisions investigating money laundering and the underlying financial structures that make it work. State and local police also investigate cases that fall under their jurisdiction. Because global financial systems play a major role in most high-level laundering schemes, the international community is fighting money laundering through various means, including the Financial Action Task Force on Money Laundering (FATF), which as of 2005 has 33 member states and organizations. The United Nations, the World Bank, and the International Monetary Fund also have anti-money-laundering divisions.

III. Money-laundering Methods

In 1996, Harvard-educated economist Franklin Jurado went to prison for cleaning $36 million for Colombian drug lord Jose Santacruz-Londono. People with a whole lot of dirty money typically hire financial experts to handle the laundering process. It’s complex by necessity: The whole idea is to make it impossible for authorities to trace the dirty money while it’s cleaned.

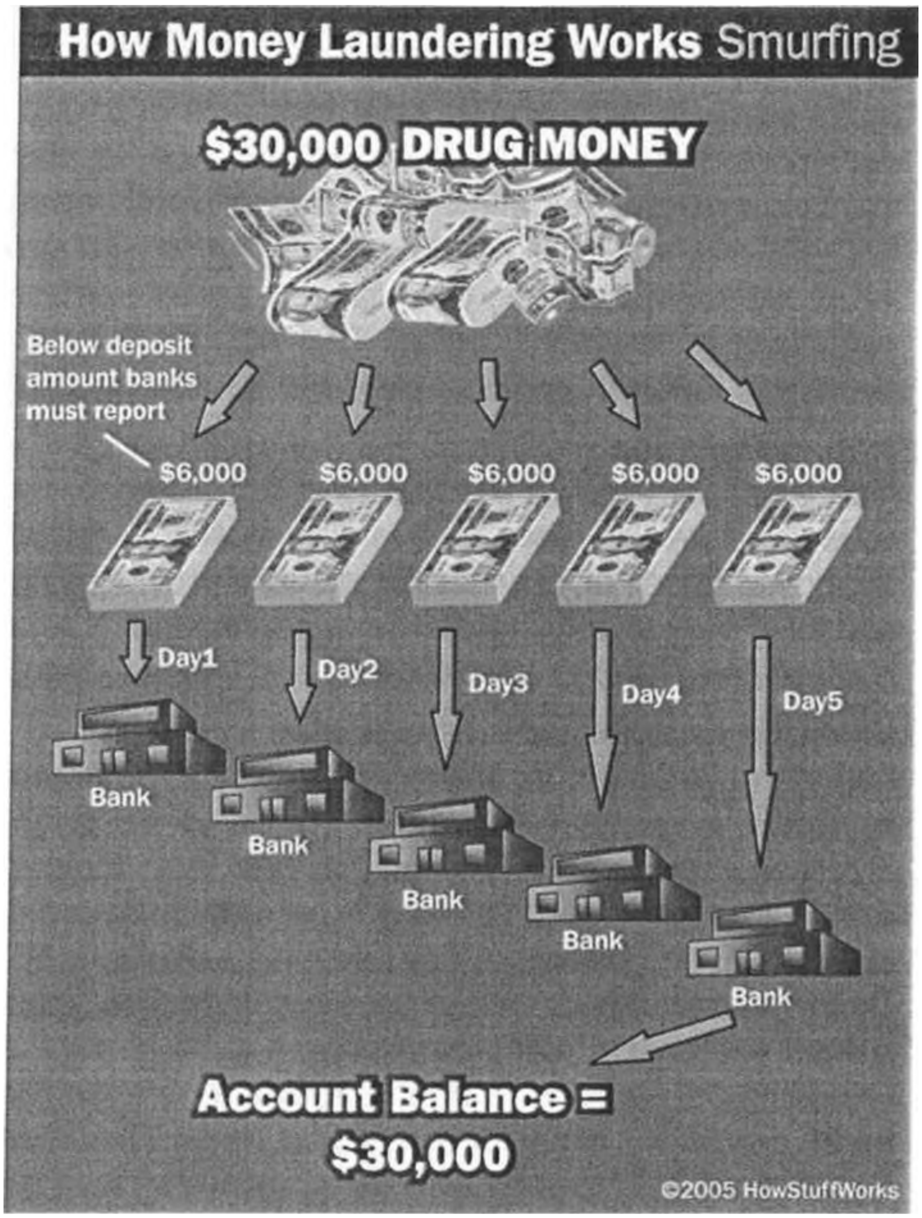
There are lots of money-laundering techniques that authorities know about and probably countless others that have yet to be uncovered. Here are some of the more popular ones:

a) Black Market Colombian Peso Exchange

This system, which the DEA calls the “largest drug money- laundering mechanism in the Western Hemisphere” [ref], came to light in the 1990s. A Colombian official sat down with people in the U.S. Treasury Department to discuss the problem of U.S. goods being illegally imported into Colombia using the black market. When they considered the issue alongside the drug-money-laundering problem, U.S. and Columbian officials put two and two together and discovered that the same mechanism was achieving both ends.

This complex setup relies on the fact that there are businesspeople in Colombia -- typically importers of international goods -- who need U.S. dollars in order to conduct business. To avoid the Colombian government’s taxes on the money exchange from pesos to dollars and the tariffs on imported goods, these businessmen can go to black market “peso brokers" who charge a lower fee to conduct the transaction outside of government intervention.

That's the illegal importing side of the scheme. The money-laundering side goes like this: A drug trafficker turns over dirty U.S. dollars to a peso broker in Colombia. The peso broker then uses those drug dollars to purchase goods in the United States for Colombian importers. When the importers receive those goods (below government radar) and sell them for pesos in Colombia, they pay back the peso broker from the proceeds. The peso broker then gives the drug trafficker the equivalent in pesos (minus a commission) of the original, dirty U.S. dollars that began the process.



b) Structuring deposits

Also known as **smurfing,** this method entails breaking up large amounts of money into smaller, less-suspicious amounts. In the United States, this smaller amount has to be below $10,000 -- the dollar amount at which U.S. banks have to report the transaction to the government. The money is then deposited into one or more bank accounts either by multiple people (smurfs) or by a single person over an extended period of time.

c) Overseas banks

Money launderers often send money through various “offshore accounts” in countries that have bank secrecy laws, meaning that for all intents and purposes, these countries allow anonymous banking. A complex scheme can involve hundreds of bank transfers to and from offshore banks. According to the International Monetary Fund, “major offshore centers” include the Bahamas, Bahrain, the Cayman Islands, Hong Kong, Antilles, Panama and Singapore.

d) Underground/alternative banking

Some countries in Asia have well-established, legal alternative banking systems that allow for undocumented deposits, withdrawals and transfers. These are trust-based systems, often with ancient roots, that leave no paper trail and operate outside of government control. This includes the *hawala* system in Pakistan and India and the *fie chen* system in China.

e) Shell companies

These are fake companies that exist for no other reason than to launder money. They take in dirty money as “payment” for supposed goods or services but actually provide no goods or services; they simply create the appearance of legitimate transactions through fake invoices and balance sheets.

f) Investing in legitimate businesses

Launderers sometimes place dirty money in otherwise legitimate businesses to clean it. They may use large business-like brokerage firms or casinos that deal in so much money it’s easy for the dirty stuff to blend in, or they may use small, cash-intensive businesses like bars, car washes, strip clubs or check-cashing stores. These businesses may be “front companies” that actually do provide a good or service but whose real purpose is to clean the launderer’s money. This method typically works in one of two ways: The launderer can combine his dirty money with the company’s clean revenues -in this case, the company reports higher revenues from its legitimate business than it’s really earning; or the launderer can simply hide his dirty money in the company’s legitimate bank accounts in the hopes that authorities won’t compare the bank balance to the company’s financial statements.

Most money-laundering schemes involve some combination of these methods, although the Black-Market Peso Exchange is pretty much a one-stop-shopping system once someone smuggles the cash to the peso broker. The variety of tools available to launderers makes this a difficult crime to stop, but authorities do catch the bad guys every now and then.

In the next section, we'll take a look at two busted money-laundering operations.

IV. Busted Money-laundering Operations

A. White-collar laundering: Eddie Antar

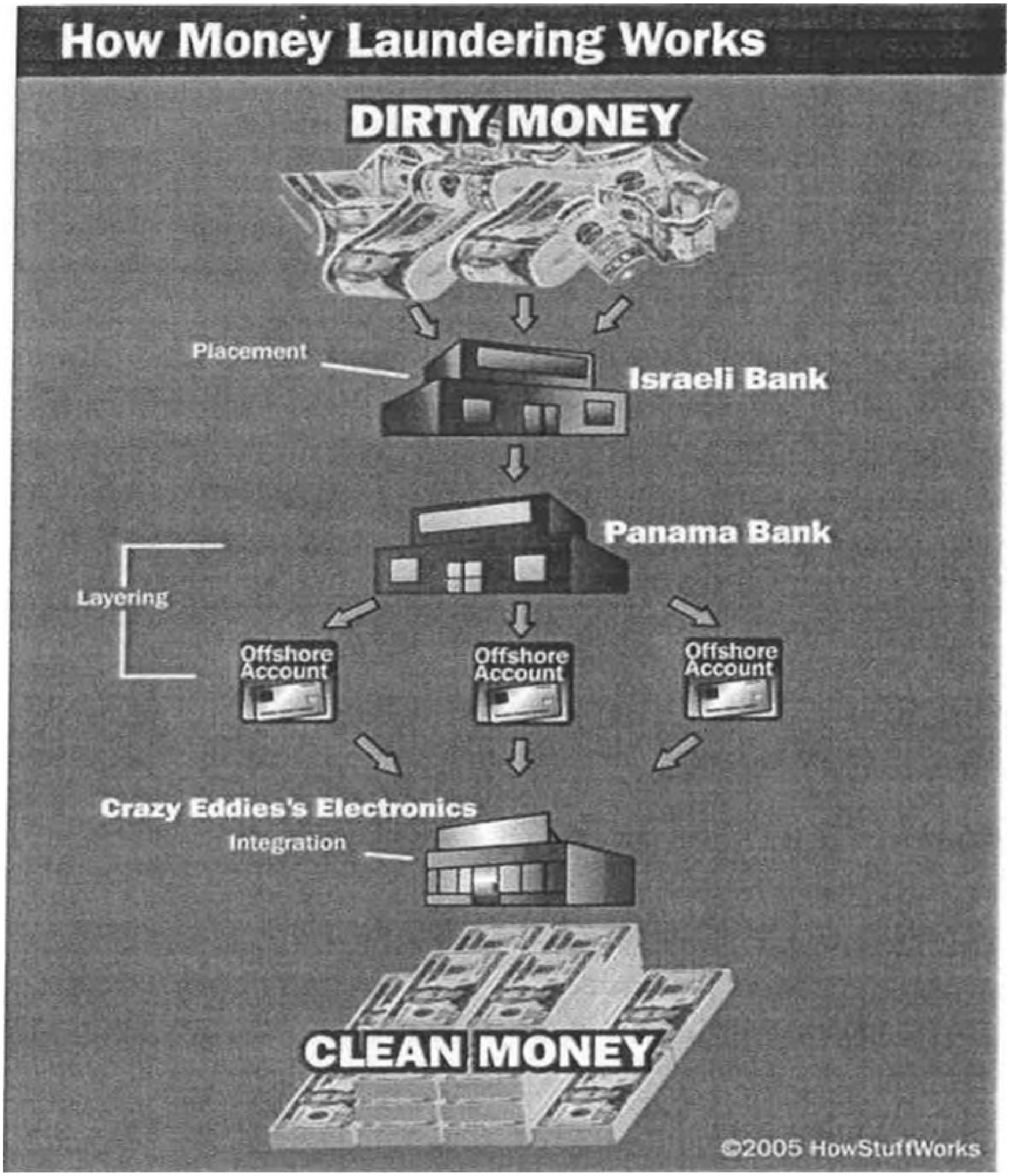
In the 1980s, Eddie Antar, the owner of Crazy Eddie's Electronics, skimmed millions of dollars from the company to hide it from the IRS. That was the original plan, anyway, but he and his co-conspirators eventually decided they could make better use of the money if they sent it back to the company disguised as revenue. This would inflate the company's reported assets in preparation for its IPO. In a series of trips to Israel, Antar carried millions of dollars strapped to his body and in his suitcase. Here's a basic recounting of how the scheme worked:

Placement: Antar made a series of separate deposits to a bank in Israel. On one trip, he made 12 deposits in a single day.

Layering: Before U.S. or Israeli authorities had a chance to notice the suddenly huge balance in the account, Antar had the Israeli bank wire transfer everything to Panama, where bank secrecy laws are in effect. From that account, Antar could make anonymous transfers to various offshore accounts.

Integration: Antar then slowly wired the money from those accounts to the legitimate Crazy Eddie's Electronics bank account, where the money got mixed in with legitimate dollars and documented as revenue.

Overall, Crazy Eddie laundered more than $8 million. His scheme boosted the initial offering stock price so that the company ended up worth $40 million more than it would have been without the added revenue. Antar sold his stock and left with $30 million in profit. Authorities found him in Israel in 1992, and Israel extradited him to the United States to stand trial. He received an eight-year prison sentence.



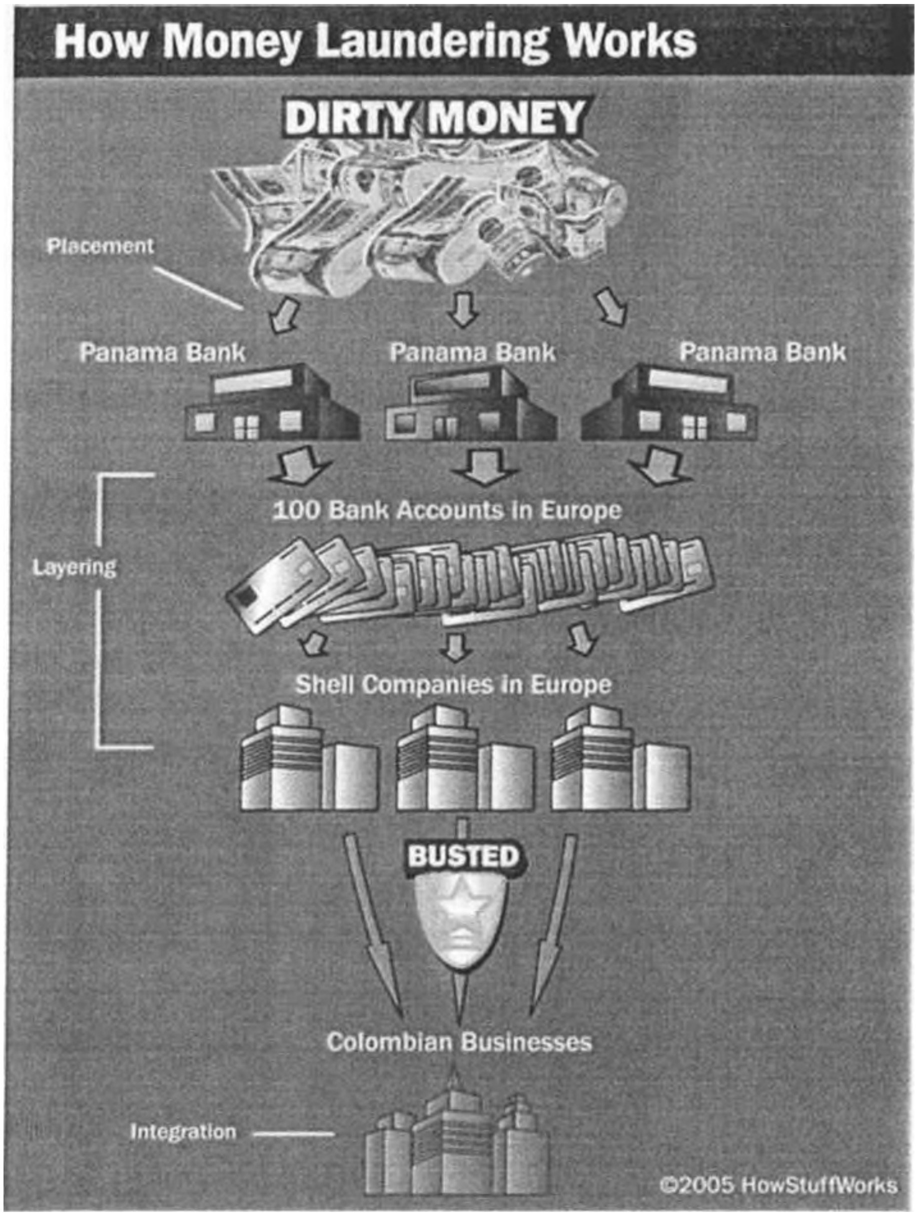
B. Drug-money laundering: Franklin Jurado

In the late 1980s and early ‘90s, Harvard-educated economist Franklin Jurado ran an operation to launder money for Colombian drug lord Jose Santacruz-Londono. His was a very complex scheme. In its simplest form, the operation went something like this:

Placement: Jurado deposited cash from U.S. drug sales in Panama bank accounts.

Layering: He then transferred the money from Panama to more than 100 bank accounts in 68 banks in nine countries in Europe, always in transactions under $10,000 to avoid suspicion. The bank accounts were in made-up names and names of Santacruz-Londono's mistresses and family members. Jurado then set up shell companies in Europe in order to document the money as legitimate income.

Integration: The plan was to send the money to Colombia, where Santacruz-Londono would use it to fund his numerous legitimate businesses there. But Jurado got caught.



In total, Jurado funneled $36 million in drug money through legitimate financial institutions. Jurado's scheme came to light when a Monaco bank collapsed, and a subsequent audit revealed numerous accounts that could be traced back to Jurado. At the same time, Jurado's neighbor in Luxembourg filed a noise complaint because Jurado had a money-counting machine running all night. Local authorities investigated, and a Luxembourg court ultimately found him guilty of money laundering. When he'd finished serving his time in Luxembourg, a U.S. court found him guilty, too, and sentenced him to seven-and-a-half years in prison.

When authorities are able to interrupt a laundering scheme, it can pay off tremendously, leading to arrests, dirty money and property seizures and sometimes the dismantling of a criminal operation. However, most money-laundering schemes go unnoticed, and large operations have serious effects on social and economic health.

C. Currency of Choice

For decades, the U.S. dollar has been the most popular currency for launders to use. Its popularity is due to its wide acceptance and the volume of worldwide transactions that use the currency -- a few million extra dollars, changing hands doesn't attract attention. However, the euro has slowly gained a foothold in the laundering industry since its introduction into common use in 2002. As far as money laundering goes, the euro could be the perfect currency: It is the main legal tender of more than a dozen countries, meaning it circulates in tremendous volume and moves regularly across borders without any notice at all.

V. The Effects of Money Laundering

Depending on which international agency you ask, criminals launder anywhere between $500 billion and $1 trillion worldwide every year. The global effect is staggering in social, economic and security terms.

On the socio-cultural end of the spectrum, successfully laundering money means that criminal activity actually does pay off. This success encourages criminals to continue their illicit schemes because they get to spend the profit with no repercussions. This means more fraud, more corporate embezzling (which means more workers losing their pensions when the corporation collapses), more drugs on the streets, more drug-related crime, law-enforcement resources stretched beyond their means, and a general loss of morale on the part of legitimate business people who don't break the law and don't make nearly the profits that the criminals do.

The economic effects are on a broader scale. Developing countries often bear the brunt of modern money laundering because the governments are still in the process of establishing regulations for their newly privatized financial sectors. This makes them a prime target. In the 1990s, numerous banks in the developing Baltic states ended up with huge, widely rumored deposits of dirty money. Bank patrons proceeded to withdraw their own clean money for fear of losing it if the banks came under investigation and lost their insurance. The banks collapsed as a result. Other major issues facing the world's economies include errors in economic policy resulting from artificially inflated financial sectors. Massive influxes of dirty cash into particular areas of the economy that are desirable to money launderers create false demand, and officials act on this new demand by adjusting economic policy. When the laundering process reaches a certain point or if law-enforcement officials start to show interest, all of that money will suddenly disappear without any predictable economic cause, and that financial sector falls apart.

Some problems on a more local scale relate to taxation and small-business competition. Laundered money is usually untaxed, meaning the rest of us ultimately have to make up the loss in tax revenue. Also, legitimate small businesses can't compete with money-laundering front businesses that can afford to sell a product for cheaper because their primary purpose is to clean money, not turn a profit. They have so much cash coming in that they might even sell a product or service below cost.

The majority of global investigations focus on two prime money-laundering industries: Drug trafficking and terrorist organizations. The effect of successfully cleaning drug money is clear: More drugs, more crime, more violence. The connection between money laundering and terrorism may be a bit more complex, but it plays a crucial role in the sustainability of terrorist organizations. Most people who financially support terrorist organizations do not simply write a personal check and hand it over to a member of the terrorist group. They send the money in roundabout ways that allow them to fund terrorism while maintaining anonymity. And on the other end, terrorists do not use credit cards and checks to purchase the weapons, plane tickets and civilian assistance they need to carry out a plot. They launder the money so authorities can't trace it back to them and foil their planned attack. Interrupting the laundering process can cut off funding and resources to terrorist groups.

So, the next question is: What are the authorities doing to prevent money laundering?

VI. Fighting Money Laundering

It's a daunting task to trace the origins of any deposit when there are about 700,000 global wire transfers occurring every day [ref]. Which is the dirty money and which is the clean stuff? Within the United States, there are two primary methods employed by the government to detect and combat money laundering: legislation and law enforcement.

The United States addresses the crime of money laundering in countless legislative acts. Here are just a few of them:

The **Bank Secrecy Act (1970)** basically eliminates all anonymous banking in the United States. It gives the Treasury Department the ability to force banks to keep records that make it easier to spot a laundering operation. This includes reporting all single transactions above $10,000 and multiple transactions totaling more than $10,000 to or from a single account in one day. A banker who consistently violates this rule can serve up to 10 years in prison.

Stopping the flow of laundered cash

The 1986 Money Laundering Control Act makes money laundering a crime in itself instead of just an element of another crime, and the 1994 Money Laundering Suppression Act orders banks to establish their own money-laundering task forces to weed out suspicious activity in their institutions. The 2001 U.S. Patriot Act sets up mandatory identity checks for U.S. bank patrons and provides resources toward tracking transactions in the underground/alternative banking systems frequented by terrorist money handlers. For a more complete list of U.S. anti-money-laundering legislation, see FDIC: Bank Secrecy Act and Anti-Money Laundering.

In addition to legislation intended to detect a money-laundering operation, undercover stings are also a component of the fight. The DEA's Operation Juno, which ended in 1999, is a prime example. The DEA out of Atlanta conducted a sting operation that involved providing resources to drug traffickers to launder money. The undercover DEA agents made deals with the traffickers to turn drug money from dollars to pesos using the Colombian Black Market Peso Exchange. The operation ended with 40 arrests and the seizure of $10 million in drug proceeds and 3,600 kilograms of cocaine.

Despite these victories, the truth is that no individual nation has the power to stop money laundering -- if one country is hostile to

laundering, criminals simply look elsewhere for a place to clean their money. Global cooperation is essential. The most prominent international organization in this respect is probably the Financial Action Task Force (FATF), which has 33 member states and international organizations on its roster list as of 2005. The FATF issued the "40 Recommendations" for banks (there are currently 49 now, but the moniker hasn't changed) that have become the anti-money-laundering standard. These recommendations include:

- Identify and do background checks on depositors.
- Report all suspicious activity. (For example, if a background check revealed that depositor A works in a steel factory, and he typically deposits $2,000 every two weeks, a series of 10 $9,000 deposits over the course of two weeks should raise a red flag.)
- Build an internal taskforce to identify laundering clues.

The "recommendations" are really more like rules than friendly tips. The FATF keeps a list of "uncooperative countries" -- those who have not enacted the recommendations. The FATF encourages its member states not to deal with those countries in financial matters.

Other global organizations fighting money laundering include the United Nations, the International Monetary Fund, the World Bank, and smaller groups like the Caribbean FATF and the Asia/Pacific Group on Money Laundering.

While increased worldwide efforts are making a small dent in the money-laundering industry, the problem is huge, and the money launderers are winning overall. Countries with bank-secrecy rules, which arguably have legitimate benefits to the honest depositor, make it extremely hard to track money once it's transferred overseas. Still, the FATF's uncooperative list has gone from 15 countries in 2000 to two countries (Myanmar and Nigeria) in 2005. By most accounts, this is a significant sign of progress. Only increased global awareness and cooperation can curb the success of the money-laundering industry.

VII. Anti-Money Laundering Program and Suspicious Activity Reporting Requirements for Insurance Companies

Insurers and agents have always had responsibilities regarding the processing of policy applications. They now have additional responsibilities related to anti-money laundering. This will be a new frontier for the majority of those associated with the insurance industry.

The insurance sector, which includes insurers, reinsurance companies, and their intermediaries (agents and brokers), face the potential risk of having their products misused by criminals and terrorist groups. Criminals look for ways of concealing the origins of illegitimate funds since knowledge of their illegal activities would bring about legal consequences. Those involved in terrorist activities look for ways to finance their acts of violence while concealing their intent. Insurance products and transactions provide an opportunity to launder money and to finance terrorism.

A. Terrorism Produces Insurer Risk

Insurers were not always recognized as having money-laundering risk. While some may still feel the insurance industry is not as great a risk as some other industries, risk does exist. Insurers and agents can knowingly or unknowingly aid in money laundering and, therefore, the financing of terrorism. This produces risks:

1. **Legal risk,** such as the possibility of lawsuits, judgments or contracts that turn out to be unenforceable which could adversely affect the operations or stability of the insurer.
2. **Reputational risk,** which is the loss of the insurer's reputation. Insurers must have the public's confidence; if that confidence is lost it will mean lost business even if the adverse publicity is not accurate.
3. **Operational risk,** which is the risk arising from failure of systems, internal procedures and controls leading to financial loss. Operational risk would include custody risk.

Insurers must take measures to prevent such risk that arises from money laundering tactics, whether it involves criminal or terrorism activities. Some measures are legally required of insurers, which will be discussed in this course.

FATF Recommendations

The Financial Action Task Force (FATF) made specific recommendations regarding the steps insurers and their employees and intermediaries could take to reduce the risk terrorist activities presented:

1. Identify their clients and potential clients using reliable, independent source documents, data and information.
2. Determine whether the client is acting on behalf of another person. Take reasonable steps to obtain sufficient identification data to verify the identity of that other person.
3. Identify the ultimate beneficial owner, and take reasonable measures to verify the identity of that beneficial owner so that the insurer is satisfied that it knows whom the person or entity is.
4. Obtain information on the purpose and intended nature of the business relationship and any other relevant factors.
5. Conduct ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the insurer's knowledge of the customer/client and the beneficial owner, where applicable. This would include knowledge of their business and risk profile including the source of funds to the extent that is reasonable and practical.

Such due diligence is essential in some types of transactions and prudent in others of a lower risk profile. Much of the due diligence will be based upon the products the existing and potential policyowners are interested in, with cash value products being the most likely to be used in money laundering schemes.

B. Legal Requirements Adopted

Although many of the current procedures are new the concern is not. Since 1970 most financial institutions have had anti-money laundering (AML) laws, requiring reporting and record keeping procedures. Both the Bank Secrecy Act (BSA) and various NASD and SEC requirements have sought to prevent money laundering. As far back as 1970 the BSA required banks to report cash transactions over $10,000 via Currency Transaction Reports (CTA). The Bank Secrecy Act of 1970 was initiated for banks, but continuous changes and additions have included other institutions as well.

In 2001 came the USA PATRIOT Act (2001 Uniting and Strengthening America by Providing Appropriate Tools to Restrict, Intercept, and Obstruct Terrorism Act). This Act requires government-institution information sharing, including voluntary information among financial institutions. Customer identification verification and related due diligence is required, as is anti-money laundering programs in the financial services industry.

Title III of the USA PATRIOT Act, referred to as the International Money Laundering Abatement and Anti-terrorist Financing Act of 2001, requires financial institutions to address anti-money laundering (AML) provisions and amendments that were added to the Bank Secrecy Act. *It is this act that extends the requirements to insurers.*

Until 2002 insurance companies were thought to be at low risk for money laundering activity so they were exempted from the USA PATRIOT Act. This changed on 12/5/2005, with an effective date of 5/2/2006. Under the FinCEN final rule, pursuant to the BSA, insurers must now establish AML programs.

The USA PATRIOT Act dramatically increased anti-money laundering awareness and proactive requirements for the insurance industry. Today insurers must establish anti-money laundering programs that also meet the Bank Secrecy Act. Of course, not all insurers are considered at risk for money laundering, so this affects some types of insurers to a greater degree than others. Only those dealing in specific products are included. Broker-dealers already have AML requirements and are not required to duplicate those already in place by the newer insurance company requirements.

Under the Bank Secrecy Act of 1970 financial institutions are prohibited from selling, using or accepting money orders, bank checks, cashier's checks or traveler's checks for more than $3,000 in currency. Larger amounts may only be accepted if the cash or cash equivalent and the purchaser's identity is verified and recorded. Even when a financial institution does not sell these items, the rules still apply.

The final rule of the BSA requires insurers to implement procedures for obtaining customer identity information and to file suspicious activity reports when applicable. The Money Laundering Control Act (MLCA) prohibits any person from knowing/engaging in any monetary transaction in criminally derived property valued at $10,000 or more.

"You sold the Mercedes-Benz to the guy who fixed our copier? For cash?"

For the agent selling automobile insurance, this might mean he or she could not insure a luxury car that was known to have been purchased with money derived from criminal activity. It is only necessary to know that money was somehow involved in criminal activity, not that these particular funds were involved or derived from a specific illegal act. Therefore, if the automobile is sitting in the driveway, already having been purchased, it is not necessary for the agent to know that illegal funds specifically purchased this car, only that the income of the car's owner comes from illegal activity.

The Money Laundering Control Act added provisions to the Bank Secrecy Act (BSA) including a prohibition against structuring transactions, which means making multiple small transactions from one lump sum, the point of which is to conceal the origins of the money. By making smaller multiple transactions the depositor hopes to avoid the BSA's reporting threshold, which would alert authorities. The multiple smaller deposits may be made in the names of multiple people, using the money launderer's family and friends to open accounts. They might also use a single account, making multiple small deposits, each of which are under the reporting limits.

The Money Laundering Abatement Act adds criminal and civil penalties that can be up to two times the amount of the transaction, not to exceed $1-million for violations of specific BSA provisions. The MLCA provides for up to 20 years in prison and/or a fine twice the laundered amount not to exceed $500,000.

A part of the US Treasury, the Office of Foreign Assets Control (OFAC) may also place sanctions on financial institutions. These provisions prohibit doing business with identified enemies of the United States or with Specially Designated Nationals (SDN), as determined by OFAC and other government agencies. Many financial institutions routinely check their customers against this list. Should a professional encounter such a person (SDN), they must contact OFAC within ten days. If a Specially Designated National is discovered to already hold an open account it must be frozen, including any pending transfers.

The Office of Foreign Asset Control prohibits working with identified money launderers, which includes companies and countries as well as individuals. Sanctions are currently in place against the Balkans, Burma, Cuba, Iran, Iraq, the Ivory Coast, Liberia, North Korea, Sudan, Syria, and

Zimbabwe. Members of drug organizations, such as Colombian drug cartels have also been identified as money launderers under the Foreign Narcotics Kingpin Designation Act. These lists are updated continually, so there may be changes or additions to the previous list.

C. Broker-Dealer Requirements

Some insurance products or insurers are affiliated with broker-dealer firms. As a result, they may be subject to National Association of Securities Dealers (NASD) requirements. NASD has specific rules for companies offering certain products, such as variable annuities. Applicants must provide certain information when opening accounts, which includes:

1. Their legal name.
2. Place of residence.
3. Whether of legal age (usually 18 years old in most states).
4. Signature of registered representative who introduces the account and the signature of the member, partner, or officer/manager who accepts the account.
5. If the customer is a corporation, partnership, or other legal entity, the names of any persons authorized to transact business on behalf of the entity must be obtained.
6. NASD Rules 2110 and 2310 require additional information.
    a. 2110 requires the firm to maintain just standards of trade, and
    b. 2310 requires the firm to gather as much as possible, information to help determine the suitability when making recommendations. Suitability information includes the client's financial status, tax status, and investment objectives.

Customer Identification Programs (CIP)

Customer Identification Programs (CIP) that broker-dealers adhere to must be appropriate for the size of their business. It should be regularly reviewed to ensure methods of verification are accurate and current. In addition, there should be procedures to check a client's name against the government's list of known terrorists.

Customer Identification Programs may use non-documentary means of identification if necessary or desirable. Companies might use reporting agencies, references, checking account information, or other public sources when the identification used by their client has expired or when the client reports that their identification has been stolen or is otherwise unavailable.

Broker-dealers should notify their customers that such identity verification procedures exist. While suspicious activity reports are made *without* notifying the client, identity verification is *not* kept secret. Government issued identifications, usually a driver's license or passport, are typically required as part of the process. For businesses, a certificate of incorporation or a business license is used. Personnel are not required to verify whether or not the identification is genuine; they must merely record the information.

The Financial Modernization Act of 1999 (Gramm-Leach-Bliley Act) protects personal financial information that might be shared by financial institutions. Prior to this Act it was common for the information gathered to be sold to other institutions. It is not permissible to obtain client information from financial institutions under false pretenses. Institutions must give clients clear notice of how and when information will be shared.

Not all suspicious clients will appear on government lists. Citizens from non-cooperative jurisdictions should also be considered with caution, since people from such jurisdictions have a high incidence of money laundering.

D. AML Program Requirements

The Department of the Treasury has instituted procedures that must be followed when an agent, broker, or insurer suspects money laundering is taking place or could take place using insurance products. This brings up the obvious question: how is an agent to know such activity is occurring or has the potential of occurring? It is that question that anti-money laundering courses attempt to answer.

Ongoing training is required under the USA PATRIOT Act. Insurers must inform their employees and intermediaries (agents and brokers) of where training can be obtained or provide training so that they may learn to detect unusual or suspicious transactions. Employees must also know how to comply with the federal rules, regulations, and reporting requirements. Relevant manuals should be available to new employees who may not have yet had such training.

The PATRIOT Act also requires companies to determine which employees need additional training periodically in anti-money laundering. Some departments are likely to need more training than others. This would include treasury, operations, margin, credit, corporate security, audit units, and legal departments. Evidence of additional training should be maintained.

Anti-money laundering program requirements are now required for insurance companies.

1. No later than May of 2006, insurers were required to develop and implement a written anti-money laundering program applicable to the products they sell.

The program must be reasonably designed to prevent the insurance company from being used to facilitate money laundering or the financing of terrorist activities. Senior management must approve the program. The insurer must make a copy of its anti-laundering program available to the Department of the Treasury, the Financial Crimes Enforcement Network, or their designee upon request.

2. A key provision of the USA PATRIOT Act says employee training can be presented through various formats, including:

1. Live presentations,
2. Videos,
3. Online training programs, or
4. Other media formats.

Insurers must notify agents of the requirements or provide some means of instruction in-house. In all cases, the program taken must comply with anti-money laundering regulations.

Regardless of where the education is acquired, agencies must develop an independent audit program to test whether it has been effective. Insurers must stress the requirements with their intermediaries and urge compliance with all aspects of AML procedures. Every employee should receive written copies of consequences of noncompliance. There are civil, criminal, and disciplinary penalties for money laundering activities.

3. At minimum, the program was required to incorporate policies, procedures, and internal controls based upon the insurance company's product risk… by assessment of the money laundering and terrorist financing risks associated with its covered products. Policies, procedures, and internal controls developed and implemented by an insurer must include provisions for complying with the applicable requirements of subchapter II of chapter 53 Title 31, integrating the company's insurance agents and brokers into its anti-money laundering program, and obtaining all relevant customer-related information necessary to ensure an effective program.

4. Each insurer will designate a compliance officer… who will be responsible for ensuring that the anti-money laundering program is implemented effectively. This would include monitoring the agents and brokers to be sure they have complied with all requirements. It will be necessary to update the program as changes or additional knowledge requires it. Appropriate persons must be educated and trained so that they can adequately meet the requirements mandated.

Besides the compliance officer, there will be others who must receive appropriate education in order to understand and prevent money-laundering tactics using insurance companies and their products. This would include the company's agents and brokers as well as other in-house employees. To accomplish this, insurers must either directly train their intermediaries and employees themselves or verify that such training has been obtained elsewhere. Some insurers will request their agents and brokers acquire this education from outside companies that provide continuing education requirements. Agents will be required to submit their completion certificate as proof of compliance.

Insurers may use some type of testing to determine if their agents and brokers understand the risks imposed by money laundering. Insurers are required under the law to have some method of determining that their intermediaries understand the risks as well as complying with these requirements. The scope and frequency of the potential testing would be commensurate with the risks posed by the insurer's products. The testing might be done in-house or by a third party. If performed in-house, the compliance officer may NOT be the person doing the testing.

Minimum requirements that must be followed by agents and their insurers, pursuant to provisions in the Bank Secrecy Act (BSA), require financial institutions to establish anti-money laundering programs and to define the companies and insurance products that are subject to this requirement. The Bank Secrecy Act (Public Law 91-508) authorizes the Secretary of the Treasury to issue regulations requiring financial institutions to keep records and file reports that are determined to have a high degree of usefulness in criminal, tax, and regulatory matters, including the conduct of intelligence or counter-intelligence such as analysis of terrorism activity.

Originally signed into law on October 26, 2001, the USA PATRIOT Act Section 352 became effective on April 24, 2002, requiring anti-money laundering programs for all financial institutions. Although insurance companies have been considered financial institutions for some time, the Bank Secrecy Act had not defined "insurance companies" for their purposes. They also had not issued regulations regarding insurance companies. There was much to be considered since insurers had different sizes, locations and services. It was felt that education of agents was a key element in detecting suspicious activity and it was also recognized that few agents had the background to detect such activity, even if it was occurring with their own clients. Since money laundering is a key element in financing terrorist activities it was important to immediately address the situation.

Not all insurers are affected by money laundering activities. For example, it is unlikely that purchasing a health insurance policy would enable an individual to launder money, although fraudulent claims against a health care policy might occur. Terrorist members and other under-world groups (such as drug cartels) look for financial vehicles that allow them to put their wealth into financial vehicles, and then withdraw untraceable funds.

5. Know Your Customer (KYC)

A program regulated by the PATRIOT Act, **Know Your Customer (KYC),** requires verification of the client's identity to the extent that is reasonable and practicable of any person seeking to open an account or place an application. The Act requires firms to maintain records of the information used to verify an individual's identity and check the names against a government list of suspected terrorists. KYC requires risk-based determinations about:

- Their customers,
- Their customer's sources of income, and
- Their customer's expected transactions.

E. Compliance

Compliance is mandatory. Compliance will be monitored by the Department of the Treasury, through the Financial Crimes Enforcement Network (FinCEN) or its delegees, under the terms of the Bank Secrecy Act. Failure to comply with the requirements could constitute a violation of the Bank Secrecy Act.

The final regulations of 31 103.137 requiring insurance companies to establish anti-money laundering programs under the USA PATRIOT Act was issued on November 3, 2005. It is actually the insurance companies (the entities in the business of issuing or underwriting a covered product) rather than the agents and brokers who have a direct obligation to establish an anti-money laundering program. Since the insurer has the size to do so, they are viewed by regulators as better able to bear the administrative burdens and associated costs of complying with the regulation's requirements. Insurers will have procedures, however, that require agents and brokers to adhere to specific anti-money laundering requirements (including education).

F. Suspicious Activity Reports Filing Requirements

The requirement to identify and report suspicious transactions applies only to insurance companies — not its agents or brokers. Insurance companies must obtain customer information from all relevant sources, which would include its agents and brokers. Any suspicious activity (based on this information) must be reported. A **Suspicious Activity Report by an Insurance Company (SAR-IC)** would be used by the insurer and must be used within 30 days of detecting the suspicious activity. Depending upon the situation, other forms may also be applicable. Prior to the PATRIOT Act insurers filed reports of $5,000 or more with the IRS. Most insurers did so voluntarily.

The threshold amount requiring an insurer to report suspicious transactions is at least $5,000, whether the cash payment is for a single policy application or multiple applications that total that amount or more. Payments made by check would not cause concern. This threshold amount is not limited to insurance policies whose premiums meet or exceed $5,000; it includes a policy in which the premium or potential payout meets the threshold. Insurance companies are encouraged to voluntarily file Suspicious Activity Reports any time they seem appropriate.

When an insurer voluntarily files a Suspicious Activity Report they are protected from civil liability to the same extent as a company filing a Suspicious Activity Report would be when required by law.

VIII. A Change In Thinking

Insurance agents are in a new era. We can no longer accept our clients at face value. We must be alert to the tactics of money launderers who use insurance products as the laundering vehicle.

A. Insurance agents and insurance brokers are specifically exempt from the definition of "insurance company" or "insurer," which means they are not directly covered by the rules. An "insurance agent" is defined as a "sales and/or service representative of an insurance company." This does not mean that agents do not have requirements regarding money-laundering activities since their insurers will be requiring specific new application requirements and mandated education on money laundering. Agents and brokers are an integral part of the insurance industry; they are certainly the ones most likely to be obtaining applicant information. This places agents in a critical position of knowledge regarding the source of investment assets, the nature of the clients, and the objectives and goals considered when purchasing insurance products.

While agents are exempt from the definition of insurance companies, the Rules require each insurance company to develop and implement policies, procedures, and internal controls that integrate the company's agents and brokers into its anti-money laundering program. This places significant oversight responsibilities on insurers. It is never easy to oversee people working independently in the field. Education seems the only efficient way to integrate agents and brokers into the prevention of money laundering activities.

The final anti-money laundering rules apply to insurance companies offering covered products, as defined in the rule. The final rule focuses on insurance products possessing features that make them susceptible to being used for money laundering or the financing of terrorism. This typically includes life insurance policies with cash surrender value features and annuity products. Cash values can be redeemed by a money launderer or can be used as a source of further investment of tainted funds. By taking out policy loans against the cash values, these individuals have received legitimate funds in place of their tainted funds. Similarly, annuity contracts offer an ideal financial vehicle for laundering illicit funds or funds whose origins must be kept secret. Annuity products allow the policyowner to exchange illicit funds for an immediate or deferred income stream or clean funds upon redemption. Products without cash values, such as term life insurance products or group policies where there is additional control, do not pose the same opportunities to money launderers.

B. Integration Stage of ML

Those involved in terrorist activities (and criminals as well) must avoid the attention that sudden wealth would bring. Therefore, they look for means of merging their illegal funds with legitimate business funds, such as insurance proceeds. This is called the "integration stage" of money laundering because they are "integrating" their illicit funds with legitimate funds. They may do so in a variety of ways, including the purchase of money orders, opening and closing small checking accounts, and by purchasing insurance products.

Illegally gained funds are typically integrated close to the operations producing the profits. Therefore, if it is drug money from Colombia it is likely that the initial stage of money laundering will happen there or at least close by. In the layering stage the funds may be moved elsewhere. If the integration stage placed the funds in an unstable economy, this might especially be true.

C. Layering Stage of ML

After the integration stage of money laundering, then comes the "layering stage," which involves moving the funds through various investments, vehicles, or companies in order to distance the illicit funds from their original source. This might be the opening and closing of multiple checking accounts at various banking institutions, or by buying and cashing out insurance products. The funds are not always illegally gained; sometimes the goal is to conceal their origin. This would especially be true for terrorists and their contacts that do not want to be identified.

D. Placement Stage of ML

The final stage of money laundering is the "placement stage." This is the process of introducing their illegal profits into the financial systems of our country. This would include buying legitimate businesses, real estate, or any item that would "place" their funds into our financial systems.

E. A Global Problem

Money laundering and the problems it creates for financial institutions around the world have not gone unrecognized by the international community. While there are no firm estimates (after all, the point of money laundering is to hide the activity) it is thought to be in the billions of dollars. The International Monetary Fund believes it could be as much as $600 trillion annually.

It is not surprising that money laundering is a worldwide problem. Money launderers seek safe havens to cleanse their money. Some countries make that easier than others. Terrorists and criminals want locations that pose the least risk to their activities. That might be a terrorist-friendly country or simply one that is not financially developed in their available technology. Eventually terrorists and criminals want to move their money through stable financial systems, such as those in the US.

One might believe that insurers would be able to tighten controls making such transactions difficult. However, it seems no matter how careful legitimate companies become or what procedures they put in place, criminals and terrorists simply become more creative. That is why we must be aware of what indicates money-laundering activity.

F. The Financial Action Task Force (FATF) was established in 1989 at the G-7 Summit in Paris as a result of international concern.

As the international community recognized the role insurers could play in Money Laundering activities they focused on creating corrective measures. Starting with 16 members, today membership has grown to 31 countries and two international organizations. The Financial Action Task Force developed recommendations that looked at insurers and focused on those businesses involving the underwriting and placement of life insurance and other investment related insurance having cash values or surrender values.

Criminals have considered insurance products a good avenue for laundering illicit funds for some time. A 2002 federal grand jury indictment against five Colombian nationals laundering cocaine money using life insurance policies demonstrated how easily it could be accomplished. Called Operation Capstone, the investigation revealed approximately $80 million had been laundered through insurance products. Although there had already been concern regarding the use of insurance products for money laundering, Operation Capstone illustrated the ease with which it could be accomplished.

The Colombian drug cartel did not purchase only US insurance policies. Policies were bought in continental Europe, the United Kingdom and in smaller jurisdictions, such as the Isle of Man. Using narcotics proceeds from the United States and Mexico, the traffickers bought approximately 250 life insurance policies in the Isle of Man alone. The insurance policies had values ranging up to $1.9 million each. They were taken out in the names of cartel associates and members of their families. Usually, they would cash out part or all of the policies prematurely, even though there were penalties of as much as 25 percent or more. While a legitimate policyholder would try to avoid such penalties, these individuals considered them a business expense in the process of laundering the illicit narcotics proceeds.

If insurers and their agents had been properly trained in anti-money laundering techniques it is likely that the cartels would not have had such an easy method for cleansing their money. In this case, they would have detected the money laundering because the policyholders were authorizing unrelated third parties to withdraw money from the cash value of their policies and were also frequently cashing out policy values prematurely.

During the last five years a number of Suspicious Activity Reports were filed that reference the use of an insurance product in suspected money laundering activity. For example, several reports described large, lump-sum purchases of annuity contracts, followed almost immediately by fund withdrawals. Sometimes the entire balance was withdrawn soon after purchase.

Most participants in the drafting of anti-money laundering legislation felt that education was key to its success. They felt it was important not to simply focus on educating the insurance company principals, but also their employees, agents and brokers who are, so to speak, on the front lines of the Money Laundering process.

G. Covered Products

Since Anti-Money Laundering requirements will involve those who deal with specific products, what does the Department of the Treasury Financial Crimes Enforcement Network (FinCEN) mean by any *"insurance product with features of cash value or investment"* under the definition of "covered products"? Their definition of "covered products" includes:

1. A permanent life insurance policy, other than a group life insurance policy;
2. An annuity contract, other than a group annuity contract or charitable gift annuity; and
3. Any other insurance product with features of cash value or investment.

The purpose of including the language of number three, "any other insurance product with features of cash value or investment," is to ensure that any newly developed products in the life and annuity field having cash value characteristics that could be vulnerable to money laundering would automatically be covered by the requirements. It is not intended that group life insurance policies or group annuities (with or without these characteristics) would be covered since group policies are administered differently than individual contracts are. There is typically a trustee or administrator involved and there are specific guidelines that govern group contracts making their use difficult for money launderers.

"Covered products" do not include term credit life, health, title, property, casualty insurance, or group products. Charitable annuities and reinsurance or retrocession contracts are also not considered covered products. If cash values become involved, this could alter how the definition affects them.

Currently insurance companies are not subject to 31 CFR 103.121 requiring them to implement a Customer Identification Program (CIP) and obtain minimum mandatory information verifying the identity of a customer. Even so, other applicable Bank Secrecy Act regulations require insurance companies to obtain and retain identifying information from customers in specific circumstances. Insurance companies must obtain all relevant and appropriate customer-related information necessary to administer an effective anti-money laundering program.

IX. Blind Faith

Agents worked for years without needing to consider terrorist activities. Following the terrorist attack in September 2001 agents recognized the need to insure property against terrorist attacks, but few of us thought we would have any direct contact with terrorist activities. It would not have occurred to most agents that terrorists and those associated with them would purchase annuities or cash-value life insurance policies with the goal of quickly cashing them out. Who would have realized that customers who paid their premiums with cash might be laundering money? Agents accepted the cash and paid premiums from their own accounts *(Zap! The money was laundered!).*

Today we realize that agents marketing life and annuity products could become an unwitting accomplice to terrorist groups by helping them launder illicit money. The name, "money laundering," is an apt description of the activity. Individuals involved with money laundering take illegally gained wealth or wealth whose origins must be hidden and attempt to clean it by mingling it with legitimate money. Money laundering is the act of cleansing wealth to make it appear legal or hide its origins.

The Financial Action Task Force (FATF) studies the methods and trends used by individuals to launder money.

Their objectives are to share information among law enforcement and financial institutions while also providing a basis for informed decisions on anti-money laundering and terrorist financing policy for the United States and other concerned countries.

FATF recognized the vulnerabilities in the insurance industry. The global insurance industry provides risk transfer, savings and investment products to a variety of consumers around the world, including individual policies, business insurance, and governments. As we have discussed, those intending to cleanse their wealth or conceal its origins use cash value products to legitimize their funds. Research conducted by FATF noted inherent characteristics of the insurance industry that make it particularly vulnerable to money laundering (ML), that characteristic being the cash values that some products contain. Inconsistent regulation and supervision across the industry was also noted as providing unique opportunities that were likely to be recognized by money launderers. When FATF looked at the insurance industry there were unusually low money-laundering detections in place, especially when compared to other financial industries of comparable size.

While there are no specific facts on the extent to which the insurance industry has been exploited by money launderers, there is no doubt that it has taken place, as witnessed by Operation Capstone. The specific aim is to prevent not just crime lords from using the insurance industry, but specifically to prevent terrorist organizations from doing so. Worldwide the insurance sector generates premiums of some USD 2.941 trillion per annum so the potential for abuse is obvious. In some product areas, premium dollars have doubled in the last ten years. The insurance industry gathers most of their premium through agents and independent brokers so that the insurer itself has limited control. While there are some life products marketed directly to the public without intermediaries (agents and brokers) the bulk does come directly from the field staff. An increasing share of the market is being sold by financial service industries, such as banks. While the individuals selling these products must still hold an insurance license in most cases, the fact that they work within another industry may affect how they understand insurance money-laundering schemes. Only a very small percentage of policies were found to have been purchased over the Internet or through telephone marketing. However, any significant increases in such sales could affect how anti-money-laundering procedures are considered.

X. Insurance Policy Money Laundering Techniques

Many committees and groups have studied money laundering in the hope of identifying and containing the activity. There are many methods used for money laundering. One method involves smuggling money into a particular country, such as Mexico, and placing it in a US dollar account. A draft is drawn on the account, and then moved to the United States where it is deposited or cashed.

Another money laundering technique involves many people opening and closing accounts. The deposits are often made in cash, but in multiple small amounts in order to avoid detection. Money orders or other cash equivalents may be used rather than actual cash.

Wire transfers are often used in money laundering procedures since the receiver of the funds is not likely to know if the deposit was made with cash, check, or other means. Additionally, it may not even be known where the money was deposited from, making tracking the source of the cash very difficult.

Nine Identified ML Methods

The Financial Action Task Force (FATF) identified nine typologies from their 2004-2005 study.

1. Single Premium Life Insurance Contracts

Single premium products of all kinds enable the money launderer to purchase a policy with a lump sum payment. This product is ideal because the purchaser can deposit a significant amount of money at one time. Since the annual premiums will be paid from an account, which has to be funded with the total amount, what would seem to be a lower Money Laundering risk life product actually bears the features of the higher risk single premium policy.

2. Early Policy Redemption

While every agent has probably experienced a policyholder who surrendered his or her policy early despite penalties, a client who routinely does so should be considered a potential money launderer. It is very often combined with high single premium or deposit account life insurance policies. A conspicuous fact is that some of the respective clients opted for early redemption even when it seemed very financially disadvantageous to do so. Some of these policies experienced unusually high penalties (as much as 40 percent in some cases). An agent must be suspicious when the policyowner shows little regard for the loss he or she will experience. Such early policy redemptions do not always happen immediately, though some will. Often the policyowner will wait a year or more to redeem their policies.

3. Claim Fraud

Claim fraud can occur with any type of insurance product since the intent is to receive capital from the claim rather than policy cash values. This represents a general structure of criminal behavior in the insurance sector by transferring illicit funds into clean money paid out as claims from an insurer. Agents have seen claim fraud for many reasons; money laundering is often not involved. Since claim fraud often does not involve money laundering only those cases that seem to continually happen or seem suspicious from a premium payment standpoint might point to money laundering.

4. Cash Premium Payments

Most people want a paper trail for their own protection. Therefore, most people pay major bills by check or some other method that can be proven if necessary. While the agent would issue a receipt for cash, that is not the normal method used to purchase a life or annuity product. This would especially be true if the premium required was a large amount.

In the past when policyholders paid with cash, their agent merely deposited it into their personal business account and wrote a personal business check to be submitted to the insurer. This method works quite well for money laundering since the agents themselves presented the vehicle for cleansing illicit funds.

5. "Free Look" Periods For Newly Issued Policies

Insurance policies allow a specific period of time following issuance for the new policyholder to "look it over" and decide if he or she is satisfied with the contract terms. Agents usually have a few clients who choose not to keep their policy, but usually it has to do with their client's finances or decision as to whether or not they actually need the protection.

When money laundering is the objective, individuals purchase policies they never intend to keep. These are often purchased with illicit cash. The individual may buy one very large policy or a number of smaller policies through various agents. When the policy or policies arrive the buyer cancels them and receives a refund in the form of a check from the insurer. This has allowed the money launderer to mingle his or her illicit funds with legitimate insurer funds, receiving "clean" money back.

Agents should question a sale if the buyer seems more concerned with the size of the premium (preferring larger premiums) than with the benefits of the policy being purchased and pays the premium with cash. It is important to note that it need not be a cash value policy since the goal is not withdrawing values but rather canceling the policy soon after issuance.

For Example:

Rick buys a nursing home policy requesting the highest benefits available. The premium comes to several thousand dollars and Rick pays with cash. Once the policy is issued and delivered, Rick cancels it and receives a refund check from the insurer.

The policy selected will be some type that produces a significant premium amount. The individual may buy the same type of policy from several different insurers, canceling all of them upon issuance and delivery. Our example of a nursing home policy would probably not be significant enough in size unless Rick could pile on enough benefits to make the cost high (and worthwhile). The more likely type of policy would be an annuity or an Investment Bond.

6. Collusion of Customer Intermediary and/or Insurer Employee

Most agents and employees of insurance companies are honest people, but those who deal in illicit funds are sharp observers. They often recognize individuals who can be manipulated. Of course, there are also dishonest people who need no manipulation at all — just the promise of wealth.

There have been several cases of collusive behavior between the customer and the agent or between the intermediary and the insurer. The intermediary (an agent or broker) involved accepted illicit funds and transferred them in exchange for high commissions. There was a case in Canada where a drug trafficker purchased a life insurance policy informing the agent that the funds came from illegal activity. The agent charged a higher commission for issuing the policy. Three months later, the policyholder cashed in on the policy.

7. Third Party Premium Payments

This typology pays the premiums on policies through third parties. A third party is a person who is not the policyholder and who has not been subject to identification by the writing agent or issuing company. Therefore, neither the agent nor the insurer can verify the person or the relationship to the policyholder.

8. Risks Involved in International Transactions

International transactions exist in a variety of ways. It may be a simple payment of premiums from a foreign bank account or the payout of policies to a foreign jurisdiction. Exercising a foreign transaction is not necessarily a sign of money laundering of course. Typologies include those with more complex transfers where the goal may be the concealment of money origins. When transfers are complex (moving money via bank accounts or checks through different jurisdictions) complicating the control of the legal source of funds, it should be considered a suspicious situation. When money laundering is the goal, it may involve foreign customers and customers domiciled abroad who seek insurance policies through domestic or foreign intermediaries. The policy payout is usually to a foreign jurisdiction.

9. Fraudulent Customers, Insurers, or Reinsurance Companies

FATF noticed that criminals established or took over complex corporate structures and then entered into business relationships with insurers to get coverage. The purpose of the various commercial insurance contracts was to invest illicit funds. In some cases, this was facilitated by the fraudulent setting-up of insurance or reinsurance companies for the purpose of laundering money. The criminals were able to invest proceeds of crimes into legal business entities and initiate transfers of money behind the veil of an insurance company or reinsurance company.

XI. Money Laundering Indicators Not Unique to Insurance Products

Some aspects of money laundering are not unique to the insurance industry. Of course, money laundering will exist anywhere there are vehicles to accomplish the illegal act. The following are characteristics of money laundering wherever it may occur.

A. Large One-Off Cash Transactions

The use of cash in situations that would not normally call for cash should always cause suspicion. This is especially true today when we have so many methods available to us to pay for goods and services. The insurance industry is one that is unlikely to need cash to acquire the products they produce. If insurers were retail stores we might not be so suspicious of cash sales, but we are not retail dealers; we are agents who would normally expect to receive a check for our products.

B. Use of False Addresses

Most agents would assume it was a simple error if their customer's mail was returned to them as undeliverable (and in the past that would be a correct assumption). Today, however, given the number of cases in which fraudulent customers have been involved (accounting for 7% of total cases), agents must be aware of the potential that exists for receiving purposely incorrect information from clients. Agents must now check key personal data provided by their customers and increase the attention they give to verifying its correctness. Most agents will request a piece of identification during the application process, or follow whatever instructions are given by their insurers.

C. Overseas Business From Higher Risk Jurisdictions

There was a time when only a handful of agents expected to receive business from foreign countries but times have changed. International transactions are one of the riskiest from the standpoint of money laundering and this is especially true of certain high-risk jurisdictions. Of course, that does not mean that all international transactions are forms of money laundering but it does mean that agents and insurers alike must be aware of the potential involved in such cases. Most insurers will be requiring enhanced identity verification and monitoring procedures to guard against potential money laundering tactics. This is particularly true for business coming from NCCTs (noncooperative countries and territories) and tax havens, since the rerouting of funds through foreign locations and intermediaries is commonly used to further screen the origins of the funds.

If the Treasury Secretary decides a money laundering concern exists involving a foreign jurisdiction or an institution, they may require record keeping and reporting of certain financial transactions, including the identities of those involved.

XII. Policyholder Characteristics and Behavior

Most of our policyholders are not terrorists and are not attempting to launder money. That's the good news. Some of our potential policyholders may be trying to use insurance products to launder illicit funds or to hide the origins of their premium dollars. That's the bad news. How can an agent or broker tell the difference?

A. A customer's profile is the most likely way to differentiate between the typical policyholder and the individual who has a different agenda.

The profile should look at both the individual's financial and personal data as it relates to the products they are interested in purchasing. Some indicators will pertain only to the insurance industry while others would be universal to all industries. At all times the agent must be aware that having these policyholder characteristics does not necessarily signify illegal behavior. Even so, when a policyholder raises suspicions it is necessary for either the insurer or the agent/broker to verify the reasons for the activity or characteristics.

There are particular clients that would automatically be considered high risk. This would include citizens of uncooperative jurisdictions that have been identified by FATF as money laundering havens. While coming from such a jurisdiction does not automatically make the individual or company a criminal it should alert the agent to the possibility.

Companies or clients whose *funds* come from offshore banks or uncooperative jurisdictions must also be considered questionable.

Finally, senior foreign officials and their family members or political figures whose transactions of funds could be the result of embezzlement or misuse of public funds must be considered as potentially suspicious.

Even when these individuals are not on OFAC or SEC lists, they have a higher potential risk so agents must use caution when doing business with them. To consider the previous list in respect to filing a suspicious activity report (SAR) some elements would be considered, including:

1. Whether or not the client has been with the agent or insurer for an extended period of time. A client that has been with the agent or insurer long enough to have a record of normal insurance transactions could be viewed without suspicion, whereas a new policyowner might warrant suspicion.
2. How the client was obtained. Was he or she a referral from a trusted long-term client? Did the client call the agent with a request to purchase a specific cash value product? If so, how did he or she hear of the agent? These questions can easily be asked and the answers could prove valuable when assessing the threat of money laundering activity.
3. Whether the client's business is more likely than others to involve money-laundering opportunities. For example, cash intensive businesses offer more opportunity to launder money than those that seldom use cash.
4. The client's home country may indicate a greater likelihood of money laundering activities since some jurisdictions are known for doing so.

Should an agent decide that suspicious activity is taking place, and especially if the agent is concerned that a terrorist act might occur, he or she must call the Financial Crimes Enforcement Network's Financial

Institution's hotline: **1-866-556-3974.**

In addition to filing an SAR, the agent would be required to contact the proper authorities immediately.

All SAR reports are confidential and it is not necessary or even advisable that the individual in question be told of the report's filing. If an agent is subpoenaed in response to the filing of a suspicious activity report, the agent is not required to provide any information. He or she should immediately contact FinCEN.

If an insurer receives a subpoena, it should not confirm or deny the report. The insurer should contact the Chief Council at the FinCEN office at 1-703-905-3590.

B. A Known Criminal or Criminal Associate or Relative

Many people have relatives or past associates that are less than angelic. That does not automatically make him/her a terrorist or a criminal. However, when suspicious activity and criminal association are combined it should raise suspicions that must be either confirmed or denied. While it is unlikely that individual agents or brokers would be aware of a person's past criminal history there are cases where an individual is so well known that it would be hard not to have such knowledge.

Usually, suspicion is not raised because an agent or broker is aware of a client's past criminal history. Instead, it is how they purchase or use policies that would cause concern. That concern would then be cause for effective customer due diligence procedures and the use of normal information sources that may provide necessary knowledge to prevent money-laundering activity.

C. Erratic or Abnormal Use of Policies

Most policyholders purchase a policy for a specific reason; once purchased the contracts are allowed to perform as they were designed to perform. A person who buys a policy for money laundering purposes generally does not use them in a typical manner. Those who are using insurance contracts to launder money may deposit unforeseen funds (that do not seem consistent with their income or lifestyle), make abrupt withdrawals, or have unjustified intervention of third parties who make deposits or withdrawals on the policyholder's behalf. There may be an unacceptable refusal to provide information about him or herself or pertaining to intervening third parties. Ideally, the agent should know their customers well enough to be able to assess such events and make evaluations, but it is unlikely that we will know all of our customers well enough to do this. What we can do is know our customers well enough to recognize abnormal behavior and report such incidents when prudent.

D. High Premiums Compared to Verifiable Income

Agents are now required to obtain reasonable information regarding their client's incomes and finances. Through the sale of financial vehicles, we have the ability to ask questions of a client that we would not ask in a social situation. Data concerning a client's economic standing is vital for assessing the consistency of behavior and of the transactions being initiated. Because insurers have a history of paying particular attention to their individual customers they have been able to make long-term investments that other industries that lack specialized client knowledge cannot do with short-term speculative financial instruments. Therefore, it may actually be easier for insurers to protect themselves from illicit funds and those that launder them.

Most insurance products are purchased through continual payments, usually monthly or quarterly, over a period of time. These payments are typically related directly to the policyholder's personal earnings, rather than originating from other financial sources. When there is inconsistency between a customer's verifiable economic profile and the scale of investment in insurance products, it is a significant indicator of possible money laundering, which would certainly require further investigation.

E. Lack of Concern Over Charges or Costs

The typical policyholder is always concerned about surrender penalties or other costs that might remove part of their policy values. Anyone who is not concerned must have a reason. Agents must ask themselves what that reason might be. If the lack of policyowner concern exists because he or she has no intention of terminating prior to maturity, which would activate a penalty, there is probably no reason for concern. If, on the other hand, the policyholder terminates a contract prior to maturity triggering a significant penalty there is valid reason for concern since it is a sign of money laundering risk. Money launderers seldom care what policy costs exist because they consider them a valid cost of doing business (screening their illicit funds through an insurer, receiving back funds that appear legitimate).

F. Undue Interest in Payout Options

A client who withdraws sums that trigger losses of contract values (whether penalties or other costs) displaying no concern regarding these losses should raise suspicion. When a new policyholder is less concerned with policy benefits and more concerned with potential payout options, agents must recognize the risk this signifies. It means that the client may initiate behavior at a later stage, even if not currently, that might signify money laundering.

G. Change of Beneficiary

While it is not unusual for a legitimate client to change their beneficiary, a widely observed and effective indicator of risk relates to repeated changes in the beneficiary designation of a policy. Repeated and unexplained changes increase the chance that money laundering is occurring. Such events gain further significance in those cases when the relationship between policyholder and beneficiary is not clearly established. Payout requests may be made on the basis of death, with proceeds going to unsubstantiated beneficiaries.

H. Insurance on Assets That Appear Inconsistent With Income

Criminals are like the general population: they insure the assets they acquire. Insurers that are asked to insure assets that have been acquired with no means of income are an indicator that illegal activity exists. It is an effective indicator of inconsistencies between the customer's economic profiles and the values or assets they are seeking coverage for.

I. Early or Suspicious Claims

It is known that general insurance is affected by money laundering risk. In other words, insurance products that do not produce a cash value may also be at risk from money laundering activities. Typologies demonstrate that money launderers also may purchase contracts and submit suspicious claims or claims very early in the policy. A claim placed by a policyowner after a very short period from the issuance may be related to frauds or may signal that the coverage was sought for money laundering purposes. Agents who stay in contact with their clients are those who are most likely to recognize fraudulent behavior.

> **When opening a new account/application, consider suspicious activity** for an individual the agent has never met before, there are specific money laundering indications to be aware of. While many of these seem very similar to the previous characteristics these should specifically be applied to the new client filling out an application.

These characteristics would include:

1. An unusual interest in the insurer's compliance record with government reporting requirements. The individual might ask the agent whether he always confirms client income, for example, stating that privacy is very important to him.
2. When an agent requests government identification (such as a driver's license or passport) and the new client is not able or is reluctant to produce this, it may be an indication of possible Money Laundering activities or intent.
3. If the new client seems vague or reluctant to give information regarding his business activities or income sources the agent should be suspicious.
4. If the new client has difficulty describing how his business operates or seems to lack knowledge regarding it, suspicion should be aroused. Agents can determine this very casually through normal conversation and should do so since it is a valuable tool in detecting Money Laundering activities.
5. If the new client seems to be acting on behalf of another but refuses to provide identification information of that person or company, the agent should consider the client suspicious. Comments such as "He wishes to remain in the background" or "That is classified information" are strong indications of money laundering intent.

6. If the individual indicates a desire to make insurance transactions that do not make good business sense the agent must consider the person suspect.
7. Transactions that seem to be evading BSA requirements are always a risk indicator. This would include making multiple policy applications using cash in amounts below normal reporting requirements.

Of course, if any identification does not seem genuine the agent must be suspicious. While the agent is not legally required to investigate the authenticity of produced identification material, if it seems to be false, it is necessary to note this with the application sent to the insurer's underwriters. In fact, any indication the agent has of potential money laundering activities must be reported to the insurer. Certainly, knowledge of the use of illicit funds to purchase insurance products must be reported by the agent.

Anytime an existing or new client is not concerned with a product's performance an agent's radar should be on. Most of our clients have a definite concern with policy performance so a lack of concern would be a prime indicator of illegal intent. If the applicant or existing client also displays a desire to avoid required government reporting requirements there would be little question as to their intent.

Sometimes illegal intent is not as obvious so it is important to recognize <u>other signs that might indicate suspicious activity</u>. This would include (but may not be limited to):

- A desire to deal only in cash or cash equivalents (money orders, cashier's checks, or traveler's checks).
- Multiple fund transfers, often going to and from countries listed as non-cooperative or high risk.
- Multiple wire transfers for no apparent business purpose.
- Purchase of long-term use products, but either withdraws funds from or closes the vehicle prematurely. Especially if more than one of these products is used in this manner it would indicate Money Laundering activity.
- Makes requests to wire transfer funds from the insurance product to a third party or company without any apparent reason for doing so.
- Deposits bearer bonds followed by requests for distribution of funds.
- Fees for premature withdrawals or other costs associated with product use do not seem to concern the client. The client may even suggest the agent receive higher commissions than normal.

XIII. Product Characteristics and Maintenance

Once an insurance policy is purchased, agents are often in a position to better understand their clients and any possible connections that might exist to money laundering activities. While the following activities do not individually indicate money laundering activities, when combined or exercised repeatedly the agent should consider them suspicious.

A. Policy Payments From Third Parties

Policies typically are purchased and paid for by the policyowner or the insured, which may or may not be the same person. If the policyowner is not also the insured, the writing agent probably understood the relationship between the two when the policy was applied for. This information would likely be relayed to the underwriter of the insurer.

A third party is a person that was not part of the original application so the agent and insurer have no knowledge of their identity or relationship with the insured or policyowner. Involvement of third parties could signify that the policyowner is a figurehead on behalf of the real provider of financial resources invested in the policy, with the intent of concealing the origin of the premium dollars or investment dollars.

B. Multiple Sources of Funds to Pay Premiums

It is unusual for premium funds to originate from multiple sources, even when all sources are tied to the policyowner. Most people signify one specific source for their premium payments, often utilizing automated payment methods such as checking account drafting. When premiums are paid from multiple sources it may indicate operations of layering or the integration stage of money laundering.

C. Significant Premium Top-Ups to a Policy

Sizeable or regular premium top-ups, especially if not anticipated at the time of policy application, is a key indicator of money laundering risk for investment types of life products.

D. Overpayment of Premium

Overpayment of premium, especially when followed by a request for repayment to a third party or another jurisdiction, is a sign of money laundering. This is an effective method of exchanging illicit funds for legitimate insurer funds. It is also effective in hiding the origin of funds. Insurers often detect this, however, and may refuse to finalize the transfer or report the request for transfer to the designated authorities.

E. Using An Insurer Like a Bank

Insurance companies are offering more financial options than ever before. Many investment type life policies offer considerable flexibility in the making of additional premiums or early redemption. When these features are used in ways resembling banking activities (making additional premium payments and frequent partial withdrawals) this is an indicator of possible money laundering. The risk is increased if transferring funds are received or paid to numerous accounts or to foreign jurisdictions. This especially applies if the jurisdiction is considered risky or non-cooperative or if the foreign exchange restrictions are in force in the receiving jurisdiction.

F. Early Redemption

As we have discussed, early redemption is a common method of laundering money. It enables an individual to invest tainted money and remove legitimate money. Therefore, individuals who seem interested in withdrawal options over their interest in policy benefits should be suspected of money laundering. Of course, asking such questions does not make a person a money launderer and their motives may be quite innocent. If, however, policyholders actually exert their right to terminate a policy before its maturity, the agent should consider this a potential money laundering risk. This would especially be true if no logical reason was given for the withdrawal or policy termination and the transaction was significantly uneconomic for the policyowner. Some money launderers look for policies that will not penalize the agent (require return of commission) for early surrender since these individuals do not wish to alert the agents to their activity.

G. Unusually High Commission Charges

Studies have shown that policies paying unusually high commissions are often selected by money laundering groups or individuals. In some cases, the intermediary (agent or broker) was directly or indirectly involved in a money laundering operation. In other cases, the intermediary sensed the transactions were shady and therefore selected a higher commission for him or herself.

XIV. Customer Due Diligence (CDD)

There is little doubt that customer due diligence (CDD) is required on all levels of the insurance industry if money laundering activities are to be minimized. The quality of customer identification is pivotal to preventing the use of insurance products for terrorism purposes. Under the USA PATRIOT Act, verification of new accountholders will be focused on. The Treasury Secretary issued regulations establishing standards for customer identification that must be applied to all new account applicants. Insurers must:

1. Verify the identities of the new account holders.

2. Maintain records of the information used to verify a person's identity.
3. Consult government lists of known or suspected terrorists and associated terrorist groups prior to issuing policies.

Failure to identify potential terrorists and criminals will allow money laundering to continue unchecked. CDD should be considered as a specific feature of financial intermediaries' risk management. Therefore, failure to adequately identify an applicant early in the application process merely magnifies the problem later in the business relationship if the agent must correct the omissions. Why would an agent not properly identify a new applicant? The Financial Action Task Force stated in their 2004-2005 report that the most likely reasons include lack of expertise, time pressures, and lack of appropriate insurer requirements. Intermediaries are not directly accountable for customer due diligence but they are accountable for following insurer requirements. Since it is obvious that intermediaries, such as agents and brokers, have direct contact that the insurer does not have, it is sensible and prudent for insurers to require specific identification processes during an application completion.

Agents and brokers are those most likely to initially notice suspicious activity. While agents want to concentrate on earning a living rather than looking for suspicious activity, it is evident that those times are gone. It is the agent, during face-to-face encounters that would recognize strange client behavior or an economic profile that may justify the filing of a Suspicious Transaction Report (STR). It is self-evident that agents and brokers must comply with anti-money laundering procedures that enable their insurers to prevent the activity. Agents are in the best position to realize if policies are being written on assets that do not seem consistent with the individuals' income or economic level, for example.

One of the concerns regarding placing too much responsibility on the field staff that meet face-to-face with their clients is the intermediary's possible reluctance to ask the necessary questions of new applicants. Intermediaries have incentive to make the sale, not discourage it. It is hard to imagine Amy Agent saying to her new applicant: *"I can't take this application because I can't verify where your premium dollars are coming from."* That is why education is necessary so Amy Agent realizes she is not required to state this. Instead, she should complete the application, attach her notes regarding the fact that cash was used and she could not see means of income, and forward it to her insurer with the application.

Of course, there will be intermediaries who suspect illegal activity but say nothing since they are receiving commissions on the applications they accept. In the long run, this will not be prudent. It will eventually become evident to the insurers that suspicious activity is occurring. If it all seems to flow through a particular agent there will eventually be consequences.

It is not always easy to recognize suspicious activity. In general, agents were not trained in money laundering activity so they were not alert to the signs. Surveys have revealed that agents typically believed the insurance business was not at risk for money laundering activities. However, actual risk, as measured by the number of cases involving insurance products and businesses, does exist. This false sense of security that agents and brokers have originated from our lack of recognition of the potential use of cash value products and generally poor understanding of the money laundering business. Few agents really believe they will personally experience a client with criminal intent.

Agents and brokers can no longer ignore the facts. Insurance products offering cash values are at risk and have been used for many years to launder money. Those involved in money laundering do not care how high surrender penalties are or what charges may apply for early redemption. Insurance products may be used during any stage of the money laundering process (integration, layering, or placement). However, insurance products are primarily used during the second and third stages, the “layering stage” and the “placement stage” since that is when the financial services industry works best for them. During the layering and placement stages of money laundering, criminals and terrorist groups are concerned with their expected return and its degree of liquidity, meaning the ease by which the asset can be liquidated providing cash for their activities or undetectable cash returns.

Once money is deposited into some type of financial vehicle, such as a cash value insurance product, the origins of the illicit funds has already been partially obscured so it becomes easier to layer and place the partially laundered funds. The link to the money’s origins may be very difficult to determine at this point since premium may be paid from a legitimate bank account or by a cashier’s check. Not all such transactions are money laundering of course; it may be a repositioning of assets from a Certificate of Deposit into an annuity; the client may have received an inheritance or even lottery winnings. It is the job of the agent to determine, within reasonable means, the origin at the time of application.

For example:

"Okay, Mr. Smith, do you wish to reposition an asset into your new annuity or would you prefer to make periodic payments from your checking account?"

"I am so sorry, but I am not in a position to accept cash. If you could deposit that into your checking account, I can accept a personal check and allow you time to make your deposit."

Seldom would a client be reluctant to state where premium dollars or a deposit originates. In fact, more often the client is proud of their ability to save if that is the case. A new applicant that is reluctant to disclose the origins of premium dollars would be suspicious.

Unlike the banking industry, insurance companies have not seemed to establish information-sharing devices as they relate to money laundering, which reflects their belief that it is a banking problem rather than an insurance industry problem. Criminals were quick to recognize this delusion of agents, brokers, and insurers.

It is generally felt that insurers have not done an adequate job of monitoring and training their intermediaries. In their defense it is very difficult to monitor a group of mostly self-employed contractors. This has been an issue prior to money laundering as the insurance industry experienced agents who were inappropriately replacing consumer's policies, overselling to consumers, and generally ignoring some of their field responsibilities.

A number of case studies have found instances of collusion between criminals and intermediaries. In some instances, businesses placing insurance products were reportedly set up for the primary purpose of money laundering. This activity can be curtailed where there exists an effective system of licensing checks at the point of establishment of new companies.

It is very difficult for regulating agencies to monitor an international industry, especially one that is growing as fast as the insurance industry is. In many foreign jurisdictions, they lack a mature financial sector, so there is ineffective supervision of the industry.

It is quite effective for money laundering activity to establish fraudulent businesses in the general insurance and reinsurance sector. Such corporate structures are particularly effective instruments for money launderers, especially when there is absence of authority controls in the jurisdiction's general insurance and reinsurance markets. Some foreign jurisdictions are in their infancy compared to the area's rapid insurance development. Money laundering activities look for such opportunities.

XV. In Conclusion

As competition from various financial markets intensify, insurance products have emerged with products designed to compete in the worldwide market place. Many of these new products appear to be more investment than traditional insurance. Unfortunately, the market expansion and product changes have not been developed with a corresponding understanding of the money laundering tactics used by criminals and terrorists. In the past, there did not seem to be a risk of criminal and terrorist infiltration since the products were not attractive to their goals. Nonetheless, times change. Today's products offer cash values that fit their needs very well.

Life insurance products appear to be a primary target of criminal and terrorist infiltration since substantial funds can be invested in widely available insurance products. Many of these products have a high degree of flexibility. While the honest policyholder appreciates these elements, money launderers love them. They offer the ability to legitimize illicit funds.

While the various legal authorities have attempted to identify the nature and extent to which money launderers have used insurers and their products, it is likely that whatever statistics they have arrived at do not reflect the global scale that actually exists. Additionally, the insurance industry has traditionally focused on claim fraud, which allowed criminals and terrorists to use other aspects of the industry to their benefit. In many respects, it does not matter if a claim is fraudulent or not when insurance products are purchased with illegal money. The subsequent influx of premiums from illicit funds results in money laundering, regardless of whether any underlying claim is fraudulent or not. Thus, insurers who issue policies on assets such as expensive cars, homes, or other items, accepting illegally gained dollars in exchange for their policies, launders money just as effectively as other financial vehicles that produce cash values.

Even if claim fraud is discovered, insurers and legal authorities are likely to concentrate on the act of the fraudulent claim and not on the origins of the money that purchased the product. In the past, the origin of the funds was never the issue and many in the insurance industry have not broadened their view to include the original and subsequent premium dollars in their fraud investigation.

Should the public ever suspect that an insurer (whether rightfully or wrongfully concluded) is aiding terrorist activity or even criminal activity, through their products it is likely that their legitimate business would suffer. It is likely that American consumers would feel very strongly about any company aiding those that attacked us and may attack us again in the future. Certainly, it would mean severe financial problems for the insurer and their intermediaries.

Today's insurance agents and other intermediaries offer more products than ever before. Some agents have multiple license types enabling them to market more than simple insurance products. They may be able to sell many types of financial products, including investments and mortgages. With their face-to-face contacts they are the individuals most likely to recognize suspicious behavior from new or even existing clients. They are in an ideal position to perform customer due diligence.

There is little doubt that agents and brokers do not focus on terrorist activities or money laundering. Their primary focus is on earning a living through the commissions they earn.

Additionally, like other professionals, agents have no expectation of ever personally being involved with terrorists who have money laundering as their goal. Because most agents do not expect to have terrorists for clients, their vigilance may be poor.

Insurance companies may have been reluctant to push for more compliance by intermediaries because of their dependency on them for new business in a competitive marketplace. Also, like their intermediaries, there was a perception that their risk of money laundering through insurance products was low. Client integrity just did not seem like something that should be pursued. What has become clear is that those who need to launder their money recognized this lack of necessary oversight by both intermediaries and insurers.

It does seem that money laundering through insurers is most evident in international transactions, where the risk of money laundering appears very high. It is likely that we will see more stringent controls placed on transactions between companies in different countries. This would be true even for insurers that are dealing with foreign counterparts, especially if connections with high-risk jurisdictions can be established.

XVI. Acronyms

AML Anti-Money Laundering

BSA Bank Secrecy Act of 1970

CDD Customer Due Diligence

CIP Customer Identification Program

CTR Currency Transaction Report

EU European Union

FAL Foreign Assets List

FATF Financial Action Task Force

FinCEN Financial Crimes Enforcement Network

FIU Financial Intelligence Unit

IAIS International Association of Insurance Supervisors

KYC Know Your Customer

ML Money Laundering

MLCA Money Laundering Control Act

MONEYVAL Council of Europe Select Committee of Experts on Evaluation of AML Measures

NASD National Association of Securities Dealers

NCCT Non-cooperative Countries and Territories

OFAC Office of Foreign Assets Control

SAR Suspicious Activity Report

STR Suspicious Transaction Report

WGTYP FATF Working Group on Typologies

USA PATRIOT Act 2001 Uniting and Strengthening America by Providing Appropriate Tools to Restrict, Intercept and Obstruct Terrorism

XVII. Glossary of Terms

Agents: Professional persons who are involved in the negotiation of insurance contracts, mediating and aiming at the conclusion of the contract between customers and insurance companies for remuneration. He or she has contractual relations with one or more insurer on whose behalf he or she acts.

Brokers: Professional individuals with the same function as an agent, but who acts independently from any insurance company. He or she does not act on behalf of a company but for the client's best interests.

tooling Off Period': Also called the Free Look Period, it refers to a contractual regulation in some jurisdictions allowing for the cancellation of an insurance contract and the refund of any premiums paid within a certain contract cancellation period. For the money launderer, it allows him or her to receive clean money in place of his or her illicit funds.

Commission: Refers to the remuneration sum of money that is paid by an insurer (or in some cases, the customer) to the intermediary for the conclusion of a new, or prolongation of, an existing insurance contract.

'Free Look Period': Also called the Cooling Off Period, it refers to the contractual regulation in some jurisdictions allowing for the cancellation of an insurance contract and the refund of any premiums paid within a certain contract cancellation period. It is a method used to cleanse illicit funds.

General Insurance: All types of insurance, not just cash value products.

Integration: In the final stage of integration the criminal proceeds are treated as legitimate. If layering is successful, integration places the criminal proceeds back into our economy in such a way that they appear to be legitimate funds or assets originating from legitimate sources.

Intermediary: Refers to both agents and brokers as third parties who take up or pursue insurance mediation.

Layering: In the second stage of money laundering the launderer separates the criminal proceeds from their source by the creation of layers of transactions designed to disguise the **audit trail and provide the appearance of legitimacy. He or she** will process the funds in possibly several transactions through the financial services sector by purchasing various financial instruments. The purpose of the transactions is to break the paper trail between the funds and their origin.

Life Insurance: As it applies to the TATF recommendations, it refers to life insurance products and other investment-related insurance products.

Placement: The process of money laundering can be divided into three stages. In the placement stage the launderer introduces his or her illegal profits into the financial system, meaning he or she deposits the money with a bank or insurance company.

Premium: Refers to the payment of the customer on the insurance policy (his contractual obligation); sum of money to be paid according to various patterns; a single or a few high amount premiums possible; normally premiums are paid in periodic installments, such as monthly or quarterly.

Redemption: Refers to the refund of a certain amount or percentage of the surrender value of the insurance contract if the policy is surrendered prior to maturity.

Reinsurance: Insurance business which insures the risk of primary insurance companies.

Third Party: As it relates to money laundering, a third party is a person or entity that is not the policyholder and has not been subject to identification processes.