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Anti-Money Laundering Rules for Insurance Companies Contain New Twists

On November 3, 2005, the Treasury Department's Financial Crimes Enforcement Network (FinCEN) published in the Federal Register two long-awaited anti-money laundering (AML) rules for insurance companies.[1] These final rules, which are effective on **May 2, 2006**,[2] require insurance companies offering certain products to: (1) implement AML programs (AML program rule); and (2) file suspicious activity reports (SARs) on covered transactions (SAR rule) (together, the "insurance rules"). Even though the business of insurance historically has been regulated primarily by the states, the insurance rules give FinCEN the authority to examine insurance companies for AML compliance.

The insurance rules were the culmination of proposed rules issued in 2002, following the passage of the USA Patriot Act (Patriot Act), which required a variety of AML measures as a response to the September 11 terrorist attacks, including AML program rules applicable to all financial institutions, such as insurance companies. While many Patriot Act AML rules have been finalized, others are still pending.[3] The delays in the issuance of the final insurance rules allowed Treasury to study the insurance industry and consider how AML controls could best be applied to that industry.[4]

Both the insurance rules generally parallel the analogous rules for other types of financial institutions, such as banks and broker-dealers. There are several exceptions, however, perhaps the most important of which is the more limited scope of the rules, which apply only to insurance companies offering certain

1. *See* 70 Fed. Reg. 66,754 (Nov. 3, 2005) (to be codified at 31 C.F.R. 103.137); 70 Fed. Reg. 66,769 (Nov. 3, 2005) (to be codified at 31 C.F.R. 103.16).

2. The AML program rule applies beginning on May 2, 2006; the SAR rule applies to transactions after May 2, 2006.

3. *See, e.g.*, 67 Fed. Reg. 21,110 (Apr. 29, 2002), as amended at 67 Fed. Reg. 67,547 (Nov. 6, 2002); 67 Fed. Reg. 68,935 (Nov. 14, 2002) (temporarily deferring the issuance of AML program rules for loan companies and various other financial institutions in order to allow time to study those institutions); 67 Fed. Reg. 48,347, 48,350 (July 23, 2002) (issuing interim final rule under section 312 of the Patriot Act concerning special due diligence programs for certain foreign accounts, but noting need for final rule to ensure full implementation).

4. *See* 70 Fed. Reg. at 66,755.

products that FinCEN has deemed susceptible to money laundering, and therefore "high risk," as discussed below.

Scope of Coverage

The insurance rules apply only to insurance companies engaged within the United States in the business of issuing or underwriting the following "covered products": (1) individual permanent life insurance policies that contain a cash value or investment element; (2) individual annuity contracts that provide for the payout of a fixed or variable income stream for a period of time; and (3) any other insurance product with "features of cash value or investment." FinCEN has found these products to be of high risk for money laundering and therefore appropriate subjects for the AML rules. Insurance companies exclusively issuing or underwriting lower-risk products—such as term life insurance; group life insurance or group annuity contracts; property and casualty, title, or health insurance; reinsurance and retrocession contracts and treaties; or any other product without a cash surrender value or an investment feature—are not covered by the rules.[5] In addition, companies that offer a covered product only as an incidental part of their non-insurance business are not subject to the insurance rules.

Insurance agents and brokers are not independently required to comply with the insurance company rules. Instead, insurance companies' principals will need to ensure through compliance programs and best practices guidelines that agents and brokers distributing covered products cooperate with them in ensuring compliance with the insurance rules. This may mean that insurance companies will need to terminate business relationships with insurance agents and brokers over whom they lack sufficient control.

AML Program Rule

The AML program rule requires insurance companies offering covered products to implement no later than May 2, 2006, a written AML program that is applicable to the covered products, approved by "senior management," and made available to FinCEN or its designee upon request. Neither the rule nor the preamble indicates what type of review by FinCEN or its designee is contemplated.

Minimum Elements

The AML program must, at a minimum: (1) incorporate policies, procedures and internal controls (collectively "procedures"); (2) designate an AML compliance officer responsible for ensuring that the program is implemented effectively; (3) provide for on-going training of appropriate persons concerning their responsibilities under the program; and (4) provide for independent testing to monitor and maintain an adequate program.

Further Details

The AML program procedures must be based on the company's assessment of the money laundering and terrorist financing risks associated with the company's covered products, and must ensure compliance with other applicable AML requirements (such as the newly promulgated SAR rule). Further, these procedures must integrate the company's insurance agents and brokers into the AML program and ensure that the company obtains from these agents and brokers, or from other sources, customer-related information that is necessary for

5. While the AML Program rule does not further define a product with features of cash value or investment, the preamble to the rule suggests that it is intended to cover products with a redeemable cash surrender value, including products that allow an insured to take out a loan against a cash value, and products that permit the exchange of funds for an immediate or deferred income stream or funds upon redemption (e.g., insurance premium trust account). *See* 70 Fed. Reg. at 66,763.

an effective AML program.[6] Accordingly, while the rule does not apply directly to insurance agents and brokers, they will have to participate actively in the insurance company's AML program. The preamble explains that while an insurance company may delegate to an agent those aspects of its AML program that would be best performed by the agent, the insurance company remains responsible for the functioning and effectiveness of the AML program.[7]

The designated compliance officer must ensure effective implementation of the AML program and specifically must monitor the integration of and compliance by insurance agents and brokers.

The rule requires that an insurance company's agents and brokers receive AML training, but the insurance company need not provide the training directly if the insurance company verifies that the agent or broker has received training by a competent party. A competent party may include another financial institution that is subject to an AML program requirement, such as a bank or broker-dealer, or a vendor that offers expertise in AML training. When or how often the training must occur is not specified by the rule, but the preamble indicates that there should be "periodic" updates.[8]

Finally, the independent testing may be conducted by an outside party or an employee or committee of the insurance company, if that person does not have AML responsibilities for the company. Like the training requirement, the rule does not specify when or how frequently the testing must occur, but the preamble explains that the frequency would depend on "the insurance company's assessment of the risks associated with its covered products."[9]

SAR Rule

The SAR rule for insurance companies generally parallels the SAR rules applicable to other types of financial institutions,[10] except that it applies only to insurance companies offering covered products and to transactions involving covered products. This reporting obligation applies to transactions occurring after May 2, 2006.

Basic Requirements

The SAR rule requires an insurance company to report covered transactions that are conducted or attempted by, at, or through the insurance company, if a transaction involves or related transactions aggregate at least $5,000 in funds or other assets, and the insurance company "knows, suspects, or has reason to suspect" that the transaction meets any one of four prongs: (1) the transaction involves

6. The rule does not specify what customer information is necessary. Insurance companies are not currently subject to the customer identification program (CIP) rule applicable to banks, broker-dealers, and other types of financial institutions; nevertheless, the gathering of basic customer identification information may be necessary to implement an AML program and file SARs.

7. *See* 70 Fed. Reg. at 66,758. To the extent an insurance agent or broker is subject to an AML program pursuant to another AML program requirement (e.g., because it is a broker-dealer), the preamble suggests that an insurance company may to some extent rely on that other AML program, but the preamble is not clear about how this reliance works, and there is no indication that the insurance company is relieved of liability in the event of an error by the agent or broker. *Id.* On the other hand, the rule makes clear that, to the extent the insurance company itself is registered with the SEC as a broker-dealer, the insurance company will be deemed to have satisfied the AML program requirements for insurance companies if it has complied with an AML program pursuant to the AML program rule for broker-dealers.

8. 70 Fed. Reg. at 66,759.

9. *Id.*

10. *See, e.g.,* 31 C.F.R. § 103.19 (SAR rule for broker-dealers).

funds derived from illegal activity or is intended or conducted in order to hide or disguise funds derived from illegal activity; (2) the transaction is designed to evade any AML reporting requirements or any other regulations promulgated under the Bank Secrecy Act; (3) the transaction has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage; or (4) the transaction involves use of the insurance company to facilitate criminal activity.

The $5,000 threshold may be triggered by insurance policies whose premiums or maximum potential payouts meet or exceed $5,000.

As noted above, the SAR rule does not impose on insurance agents and brokers independent duties to file SARs. Instead, insurance company principals would need to ensure that agents and brokers distributing the company's covered products assist them in satisfying their suspicious activity reporting obligations, which may include obtaining appropriate customer information to detect suspicious activity.

SARs are required to be filed with FinCEN, using a designated FinCEN form,[11] no later than 30 days after initial detection of the facts that provide the basis for filing the SAR, or no later than 60 days if the additional time is needed to identify a suspect. In situations requiring immediate attention, such as terrorist financing or other activities with the potential to cause significant harm, insurance companies are required to immediately notify law enforcement authorities by telephone.

Insurance companies are required to maintain a copy of the SAR, together with supporting documentation, for five years from the time of any SAR filing. As with the SAR rules for other financial institutions, the supporting documentation does not need to be filed with the SAR, because it is deemed to have been filed when it is maintained by the insurance company along with the copy of the filed SAR.

The SAR rule protects insurance companies and their employees from liability for disclosures made in SARs. All SARs filed are strictly confidential; the information contained therein generally may be provided only to appropriate government law enforcement and supervisory agencies, and no person that is a subject of a reported transaction may be notified of the SAR filing. SARs generally may not be produced in litigation, even pursuant to a subpoena, and any insurance company that receives a subpoena or request to disclose a SAR or information contained in a SAR generally should decline and notify FinCEN.

Further Details

The preamble to the SAR rule provides some guidance to insurance companies on when a SAR should be filed through examples of suspicious activities or "red flags." Such red flags include: the purchase of insurance products inconsistent with the customer's needs; unusual payment methods, especially cash; early termination of a product, especially at a cost to the customer, or where payment is made by or the refund check is directed to an apparently unrelated third party; the transfer of the benefit of an insurance product to an apparently unrelated third party; little or no concern by a customer for the investment performance of an insurance product where the customer does evince concern about the early termination features of the product; reluctance by a customer to provide identifying information when purchasing an insurance product, or the provision of

11. The preamble to the SAR rule states that, before the SAR form for insurance companies is finalized, insurance companies may file SARs using the SAR form of the securities and futures industry (Form FinCEN 101). This form is available at www.fincen.gov/reg_bsaforms.html.

minimal or seemingly fictitious information; and the borrowing of the maximum amount available soon after an insurance product is purchased.[12]

Insurance companies are relieved of their obligation to file a SAR if the suspicious activity is limited to the submission of "false or fraudulent information to obtain a policy or make a claim." For example, the preamble notes that submission of false medical records by an applicant for life insurance coverage would not require a SAR in the absence of suspicion of money laundering or terrorist financing. However, if the false submission might relate to money laundering or terrorist financing, a SAR is required. Accordingly, this exception may not provide much relief since the definition of money laundering is broad and many fraudulent submissions presumably could be the basis for a criminal money laundering charge.[13]

Insurance companies that are also SEC-registered broker-dealers would satisfy their insurance company SAR obligations by complying with those SAR rules applicable to broker-dealers. The SAR rule also permits a joint filing by the insurance company and the agent involved in the transaction, provided that the SAR is labeled with the words "joint filing," that it contains all relevant facts, including the names of the insurance company and the agent, and that both the insurance company and the agent maintain a copy of the SAR along with supporting documentation.

Compliance

As noted above, even though the business of insurance historically has been regulated primarily by the states, the insurance rules give FinCEN the authority to examine insurance companies for AML compliance. The rules also state that FinCEN may delegate its examination obligations, but neither the rules nor the preambles indicate which entities may receive such delegated authority or how compliance examinations will be conducted. Information regarding these important matters presumably will come from experience, FinCEN pronouncements, or both.

12. 70 Fed. Reg. at 66,765.

13. The criminal money laundering statutes at 18 U.S.C. §§ 1956, 1957 define money laundering by reference to a broad array of "specified unlawful activities" that are predicates to money laundering. The submission of false information to an insurance company, for example, may constitute mail or wire fraud, and a subsequent transmission of money obtained from such fraud may constitute money laundering. *See, e.g., United States v. Cavalier,* 17 F.3d 90 (5th Cir. 1994) (affirming money laundering conviction based on fraudulent insurance claim and subsequent transfer of funds).

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