Anti-Money Laundering & Combating Financing of Terrorism
A Primer for Insurance Companies in India

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**Introduction**

**Evolution of Insurance Industry in India**

Insurance can be defined in brief as "A promise of compensation for specific potential future losses in exchange for a periodic payment". Insurance in India was formalized by the Insurance Act 1938. The insurance business in India is divided into four classes viz., life insurance, fire insurance, marine insurance and miscellaneous insurance. Life insurers transact the life insurance business whereas the general insurers transact the rest.

Till the year 2000, the insurance sector in India mainly consisted of only the two State insurers i.e. Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC). The first set of 16 entrants from the private sector got their registration in the fiscal year 2000-01.

India got its insurance regulator, the Insurance Regulatory and Development Authority (IRDA) (http://www.irdaindia.org) post the enactment of the Insurance Regulatory & Development Authority Act in 1999. IRDA is responsible for regulating both the life insurance as well as the general insurance businesses in India. IRDA is a ten member team consisting of (a) one Chairman (b) five whole-time members and (c) four part-time members, all of whom are appointed by the Government of India.

**Financial Action Task Force (FATF)**

In response to mounting concern over money laundering, the Financial Action Task Force on Money Laundering (FATF) was established by the G-7 Summit that was held in Paris in 1989. Recognizing the threat posed to the banking system and to financial institutions, the G-7 Heads of State or Government and President of the European Commission convened the Task Force from the G-7 member States, the European Commission and eight other countries. The Task Force was given the responsibility of examining money laundering techniques and trends, reviewing the action which had already been taken at a national or international level, and setting out the measures that still needed to be taken to combat money laundering. In April 1990, less than one year after its creation, FATF issued a report containing a set of Forty Recommendations, which provide a comprehensive plan of action needed to fight against money laundering.

In October 2001 the FATF issued the Eight Special Recommendations to deal with the issue of terrorist financing. The continued evolution of money laundering techniques led the FATF to revise the FATF standards comprehensively in June 2003. In October 2004 the FATF published a Ninth Special Recommendation, further strengthening the agreed international standards for combating money laundering and terrorist financing - the 40+9 Recommendations.

The Financial Action Task Force (FATF) welcomed India as the FATF’s 34th member country on June 25, 2010 in Amsterdam. India has been active in the Asia Pacific Group (APG) since 1998 and is the incoming APG Co-Chair effective mid-July 2010. APG will now have a strong influence on FATF policy and standard setting. Of the 36 members of the FATF, 10 are members of the APG.. The Financial Intelligence Unit, Enforcement Directorate, Central Economic Intelligence Bureau and Directorate of Revenue Intelligence will now be able to exchange vital information from other member-countries on money laundering and terrorist financing activities.

**Money Laundering**

IRDA, in its master circular on Anti-Money Laundering (AML), defines Money Laundering as "Moving illegally acquired cash through the financial systems so that it appears to be legally acquired". The goal of a large number of criminal acts is to generate a profit for the individual or group that carries out the act. Money laundering is the processing of these criminal proceeds to disguise their illegal origin. This process is of critical importance, as it enables the criminal to enjoy these profits
without jeopardising their source. Illegal arms sales, smuggling, organised crime, drug trafficking and prostitution rings can generate huge amounts of proceeds. Embezzlement, insider trading, bribery and computer fraud schemes can also produce large profits and create the incentive to "legitimise" the ill-gotten gains through money laundering. When a criminal activity generates substantial profits, the individual or group involved must find a way to control the funds without attracting attention to the underlying activity or the persons involved. Criminals do this by disguising the sources, changing the form, or moving the funds to a place where they are less likely to attract attention.

**Stages in Money Laundering**

There are three common stages of money laundering that insurance companies may unwittingly get exposed to while undertaking normal business transactions:

**Placement:** The physical disposal of cash proceeds derived from illegal activity.

**Layering:** Separating illicit proceeds from their source by creating complex layers of financial transactions designed to disguise the source of money, subvert the audit trail and provide anonymity.

**Integration:** Creating the impression of apparent legitimacy to criminally derived wealth.

**Terrorist Financing**

The United Nations International Convention for the Suppression of the Financing of Terrorism broadly defines an act of terror as:

a) An act which constitutes an offence within the scope of and as defined in one of the treaties listed by the United Nations (UN); or

b) Any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a government or an international organisation to do or to abstain from doing any act.

The act of financing such an act of terror can be termed as Terrorist Financing.
Money Laundering Vulnerabilities in Insurance

A Global Perspective

The FATF, in its report on money laundering & terrorist financing typologies of 2004-2005, identified the vulnerabilities in the insurance sector with regards to money laundering. The findings of the report are reproduced below:

The insurance sector, like other financial services, is exposed to the threat of money laundering. The insurance sector could be attractive to money launderers seeking to place funds into a financial product that will provide them with a reliable, clean return of funds invested. **If a money launderer is able to move funds into an insurance product and receive a payment made by an insurance company then he will have made his funds appear legitimate.**

Research has observed that the inherent characteristics of the insurance sector may give rise to money laundering risks unique to the insurance industry, increasing its vulnerability to money laundering. Research indicated detection of money laundering is low within the insurance industry in comparison to the size of the industry and in comparison to other parts of the financial services industry.

An important feature of the way the insurance sector operates is that most of the business is channeled through intermediaries, either tied agents or independent brokers. With reference to the life sector (as for non-life, the role of intermediaries is even more significant). An ever increasing share of the market is sold by intermediaries belonging to other parts of the financial services industry, usually banks. Branch offices of banks are widely used for selling insurance products, in particular those with enhanced investment characteristics. Currently, only a small share of the business is sold through other channels, such as phone marketing and the Internet. Any significant business increase through these distribution channels may have an effect on the way money laundering risks are perceived. The way in which insurance products are sold has relevant implications as far as AML regulation is concerned.

Presently, AML regulation does not apply to the same extent for the non-life sector and is very often absent in the reinsurance sector.

Due to the way the insurance market operates, compliance with AML regulation is required from both insurers and the intermediaries who distribute insurance products on their behalf. However, AML regulation may sometimes be applied at an unsatisfactory level. The intermediaries sometimes consider incorrectly that they do not bear the responsibility for AML compliance with regards to the obligation of verification, identification and due diligence on the source of funds. They believe this responsibility only remains with the insurers, to whom the business relations with the customers have to be ultimately referred.

AML regulation is usually applied to a limited extent in the general insurance sector. General insurance is generally viewed as prone to fraudulent schemes to the detriment of insurers, as in the case of false claims, rather than be the conduit of money laundering operations. As a result, where AML provisions do apply carve-outs and exceptions are permitted usually to reflect the perceived lower money laundering risk in the general insurance market.

As in other parts of the financial services industry, prudential supervision is applied to insurers, involving some kind of initial authorization process and ongoing prudential standards checks. Generally, insurers are registered at a centralized supervisory authority, whilst the businesses owners and management are usually required to undergo integrity checks. In the life insurance market prudential supervision is extended to intermediaries, although often in milder forms. Against this
general picture, however, regulation and supervision have emerged as being applied unevenly across the insurance industry which may provide opportunities that can be easily exploited by criminals.

In addition to those vulnerabilities experienced by all financial and non-financial sectors, which usually arise from internal fraud and collusion with criminals, the insurance sector features a comprehensive set of sector-specific weaknesses.

**Inadequate Application of AML Regulation**

In the insurance sector most of the business is channeled through intermediaries. As a result, on most occasions, it is intermediaries that in actual fact apply AML regulation on behalf of the insurer. This may cause AML regulation to be undertaken at an unsatisfactory level on two accounts. Firstly, on the basis of the evidence emerging from research, intermediaries are not directly subject to AML regulation in all jurisdictions, but held to operate as mere executors of Customer Due Diligence (CDD) procedures which they undertake on behalf of the insurers. Secondly, even though intermediaries are indeed required to comply with AML obligations, since it is the insurers to whom the business relations with the customers have to be ultimately referred, intermediaries are incorrectly considered not to bear the responsibility for compliance. The involvement of credit institutions in the distribution of insurance products may be viewed as a positive development, given the higher degree of AML regulation compliance that the banking sector normally features.

**Reliance on third parties to undertake CDD procedures:** The quality of CDD is one of the pivotal factors on which the system of AML controls hinges, since it allows the identification of money laundering risks. Failure to undertake identification and verification procedures in an adequate and timely fashion increases the possibility of money laundering going undetected. More generally, CDD should be considered as a specific feature of financial intermediaries' risk management. Therefore, not only does an inadequate client assessment (because of lack of expertise, time pressure, poor controls etc.) increase the risk of involvement with money laundering, but it also undermines the establishment of a correct business relation. As has been explained above, intermediaries undertaking CDD procedures on behalf of the insurer they operate for may not be deemed accountable for any inadequate procedures that fail to prevent money laundering.

**Suspicious transaction reporting:** It is self evident that customers placing business through an intermediary have a direct contact with the intermediary rather than the insurer. Therefore, on account of the face-to-face relationship with such clients that intermediaries enjoy, it is the intermediary who is in the position of appreciating any factor, or change, in the client's behaviour and economic profile that may justify the filing of a Suspicious Transaction Report (STR). Therefore compliance with AML provisions by intermediaries is essential.

**Lack of AML regulation in the general insurance and reinsurance sectors:** Criminals may have an interest in seeking general insurance cover for their assets. In this respect, regardless of whether the funds used to purchase those policies are proceeds from illegal activities or not, general insurance is clearly a potentially invaluable source of information from a CDD perspective. By virtue of the much larger transactional values the general lack of AML regulation in the reinsurance sector creates substantial opportunities for the laundering of large amounts of money.

**Specific Market Characteristics**

**Long distribution chains:** The weaknesses in AML regulation are exacerbated where distribution chains are long (as can often occur in the insurance sector) and undue reliance is placed on CDD supposedly carried out earlier in the chain. In this case, the availability of adequate customer’s data may be imperiled because of inadequate coordination and breakdown in the information flow. Money launderers can exploit this situation by entering the market through the weakest link in the chain.
**Intermediary incentives:** The dichotomy between legal responsibility and accountability for AML regulation discussed above is all the more evident if the different set of incentives that insurers and intermediaries respond to is taken into account. At its most basic level intermediaries may have no reason for responding to incentives other than pure economic ones, upon which their relationship with the insurer is normally mainly structured. The desire to generate income may lead disreputable intermediaries, or their staff, to either fail to undertake AML compliance satisfactorily or to take advantage of money laundering situations.

**Increasing volumes and competitive pressures:** The picture of the insurance sector emerging is that of a rapidly expanding market, competing with other parts of the financial services industry for the customer’s attention. To this end, highly diversified products are being designed whose features are much closer to that of investment products than to traditional insurance ones. Moreover, the insurance market is increasingly acquiring a consolidated international dimension, with competitors striving to get access to new and often riskier, markets. Taking a money laundering perspective of these long-term trends in the insurance sector, it may be the case that the regulatory framework and AML compliance has not kept pace with such rapid developments, and thus the safeguards and the risk-mitigating mechanisms in place are no longer as effective as previously, thus opening up increased opportunities to money launderers.

The above referred FATF typology report has also identified some indicators of money laundering for the insurance sector.

**Money Laundering Indicators**

Money laundering indicators are distinguished by the different indicators according to the following groupings:

- Indicators not unique to the insurance industry
- Policyholder characteristics and behaviour
- Policy characteristics and policy maintenance
- Other indicators

**Indicators Not Unique to the Insurance Industry**

The set of money laundering indicators applicable to all other parts of the financial services industry still apply to the insurance sector.

**Large one-off cash transactions:** The use of cash often provides an unambiguous mark of suspicious activity, all the more significant the more widespread becomes the use of alternative means of payment; however, the insurance sector, particularly in jurisdictions with a well developed financial services industry, seems less cash intensive than expected.

**Use of false data:** Use of false data was one of the key indicators for money laundering. Market participants need to check key personal data their customers provided and heighten their attention whenever unreliable or patently false information is supplied.

**Overseas business from higher risk jurisdictions:** International transactions turn out to be the riskiest from the general perspective of money laundering. This does not mean that insurance businesses involved in cross-border business are normally used as conduit for money laundering operations; however, it demonstrates that enhanced identity verification and monitoring procedures need to be undertaken whenever business relations are established with overseas customers. This is particularly true for business coming from NCCTs and tax havens, since the re-routing of funds
through foreign locations and intermediaries is commonly used to further dilute the origin of the funds.

**Policyholder Characteristics and Behaviour**

A customer’s profile, both financial and personal, represents the main benchmark against which the rationale for the transactions they perform or of the business relationships they entertain can be assessed. Clearly there may be innocent reasons why the policyholder acts in a way that initially raises suspicions, but it is for the insurer/intermediary to seek to verify such reasons.

**Where the policyholder is a known criminal, or a relative or an associate of a known criminal:** It would be unfair to relate a transaction or a business relation to money laundering only because it is connected to someone with criminal precedents, but such connections can certainly be used as an indicator of risk. It is not always possible for insurers and intermediaries to gain relevant information, such as the personal criminal records of their own customers or of their relatives or associates, which are rightly deemed to be confidential. However, effective CDD procedures and the use of differentiated sources of information may provide a deeper insight of both actual and potential customers. To this end, the implementation of channels for the exchange of information, to the extent permitted by legislation, within the insurance sector (or even wider) is desirable.

**Erratic or abnormal behaviour by the policyholder:** This includes sudden and unexplained lifestyle changes of the policyholder, unanticipated and inconsistent modification of customers’ contractual conditions, unforeseen deposit of funds or their abrupt withdrawal, unjustified intervention of third parties, unacceptable refusal to provide information about himself or about a transaction. Again, insurers’ and intermediaries’ knowledge of their policyholders should be such to enable them to assess any such event properly and evaluate its consistency with the customer’s profile.

High premium payments compared to verifiable legitimate income. Data concerning a customer’s economic standing is crucial for assessing the consistency of his behaviour and of the transactions he undertakes. With particular attention to individual customers, many insurance products in the life sector have a long-term investment nature, rather than the more speculative, short-term one, that other financial instruments often feature. Accordingly, funds used for purchasing such life policies (particularly where periodic, such as annual or monthly, premiums are paid) are usually directly related to the policyholder’s personal earnings, rather than being originated from other financial sources. Any inconsistency between a customer’s verifiable economic profile and the scale of investment in insurance products should, therefore, be held to be a particularly significant indicator of money laundering risk, requiring further investigation.

**Lack of concern by the policyholder over charges/early redemption costs:** Lack of concern by the policyholder of the cost, which is normally far from negligible, a policyholder may decide to incur for the sake of terminating an insurance contract (particularly long-term investment type life insurance) before its maturity signals an increased degree of money laundering risk, since by way of liquidating the value of the policy, the customer screens the initial source of the funds, which now appear to originate from the insurer. Money launderers appear willing to accept such costs involved in laundering their dirty money.

**Policyholder's undue interest in early payout options:** Related to the previous point, should a customer give the impression of being relatively uninterested in the return of his investment in a life policy, but rather more concerned with the conditions attached to the early redemption of the policy that may provide a particularly well-grounded reason for suspicion. Furthermore this indicator anticipates future suspicious behaviour that the customer may exhibit at a later stage.

**Change of beneficiary:** A widely observed and most effective indicator of risk relates to any change in the beneficiary of a policy that the policyholder requests in the course of the business relation.
Repeated and unexplained changes increase the chance that money laundering is occurring. Such events gain further significance in those cases when the relationship between the policyholder and the beneficiary is not clearly established.

**General insurance coverage for assets of a value that appears inconsistent with the customer’s economic profile:** It has been observed that criminals will invest at least part of their ill-gotten income in assets for which they subsequently seek insurance coverage. In order to detect instances of this sort at an early stage, one effective indicator lies in inconsistencies between the customer’s economic profile and the value of the assets for which coverage is sought.

**Early or suspicious claims in general insurance:** Typologies demonstrate that general insurance is affected by money laundering risk. Any inconsistent or uneconomic behaviour of a client should be used as an indicator of risk, as in life insurance. Accordingly, any claim placed by customers after a very short period from the initiation of a general insurance contract may be related to frauds or, of more relevance here, may signal that the coverage was sought for money laundering purposes, with a view to creating as soon as possible the circumstances for placing the claim and thus receiving clean money in the form of compensation from the insurer.

**Policy Characteristics and Policy Maintenance**

Once an insurance policy is purchased, depending on its contractual characteristics, insurers and intermediaries are able to collect further insight into the customer’s financial conduct and of the interests underlying the business relation. The way the customer manages the contract and his relationship with the insurer/intermediary may provide further effective indicators of money laundering risk.

**Policy payments made by third parties:** The involvement of third parties, especially when they pay the premiums on an insurance policy, could signify that the policyholder may operate as a figurehead on behalf of the real provider of the financial resources invested in the policy, thus aiming to provide a screen to the actual origin of funds.

**Multiple sources of funds to pay premiums:** It is unusual for funds used to pay policy premiums to originate from different sources, such as different banking institutions, even if all sources could eventually be referred to the policyholder himself. Accordingly, the purchase of the insurance policy in this manner may indicate operations at the layering or integration stage of money laundering.

**Significant premium top-ups to a policy:** Sizeable or regular premium top-ups, particularly if not anticipated at the commencement of the policy is a key indicator of money laundering risk for investment type life policies.

**Overpayment of premium, particularly where followed by a request for repayment to be made to a third party and/or another jurisdiction:** The overpayment of a policy premium with the subsequent request of the repayment of the surplus directed to third parties represents an effective method for screening the origin of funds. However insurers have in general learned to detect such instances and consequently either refuse to finalise the transfer of the funds and/or report the transaction to the competent authorities.

**Using an insurer to move funds around:** Insurers are now in the position of offering ever increasing sophisticated products to their customers and increasingly competing with other parts of the financial sector. Many investment type life policies offer considerable flexibility in the making of additional premiums and early redemption. However where such products are used by a policyholder in a fashion similar to the way one would make use of a bank account, namely making additional
premium payments and frequent partial redemptions, this is an indicator of possible money laundering. This risk is increased when transferring funds are received or paid to numerous accounts or to foreign jurisdictions (especially if a risky/ non-cooperative jurisdiction is involved or foreign exchange restrictions are in force in the receiving jurisdiction).

**Early redemption of the policy:** Any peculiar interest that a policy holder may show in early payout options or, conversely, any lack of concern that may be displayed over particularly high charges applied to such redemptions have already been pointed out as useful indicators. Likewise, insurers and intermediaries should examine with particular attention whenever the client actually exerts his right to terminate a policy before its maturity. As for all key events in the policy life, the insurer should gain an understanding for the customer’s behaviour. Any doubts in the insurer’s mind over the reason for early redemption should be increased if the early redemption takes place in the absence of a reasonable explanation or when the whole transaction turns out to be significantly uneconomic, or defeats the original advantage of holding the policy e.g. taxation breaks. An enhanced indicator for insurers of the possibility of money laundering risk is the situation where in addition to the above circumstances there is no return of commissions paid to intermediaries by the insurer at the inception of the policy.

**Other Indicators**

**Unusually high commission charges:** If intermediaries applied particularly high commission charges, i.e. in excess of the usual commission or fee charged for that type of product, to the policyholder then this indicated a high money laundering risk. It was the case that either the intermediary was directly or indirectly involved in a money laundering operation., or simply that the intermediary, either because he knew funds of dubious origin were involved in the transaction or since he could sense that the transactions featured a higher risk to himself, demanded a higher than normal commission.

**Involvement of recently established insurance or reinsurance companies or companies whose background does not appear particularly transparent:** Thus, whenever insurers or intermediaries have as their counterparts companies that are relatively new or have an opaque corporate and ownership structure, they should investigate more accurately their counterparts’ background, with a view to ascertaining whether it is real companies they are dealing with and not fake undertakings or shell companies, which may be effectively used for money laundering purposes.

Additionally, IRDA has also illustrated some indicators of suspicious transactions as follows:

- Customer insisting on anonymity, reluctance to provide identifying information, or providing minimal, seemingly fictitious information.
- Cash-based suspicious transactions for premium payment and top ups over and above Rs. 5 lakhs per person per month, and multiple demand drafts each denominated for less than Rs. 50,000/-.  
- Frequent free look surrenders by customers.
- Assignments to unrelated parties without valid consideration.
- Request for a purchase of policy in amount considered beyond his apparent need.
- Policy from a place where he does not reside or is employed.
- Unusual terminating of policies and refunds.
- Frequent request for change in address.
- Borrowing the maximum amount against a policy soon after buying it.
- Inflated or totally fraudulent claims e.g. by arson or other means causing a fraudulent claim to be made to recover part of the invested illegitimate funds.
- Overpayment of premiums with a request for a refund of the amount overpaid.
**Typologies**

There are nine major typologies observed by the FATF for the insurance sector.

**Typology 1: The use of life insurance single premium policies**

The availability of bespoke policies of this nature enables the laundering of large sums by making substantial payments into life insurance single premium policies, which serve as a wrapped investment policy. The customer actually does not seek insurance coverage but an investment opportunity. A variation on this is the use of large premium deposits used to fund annual premiums. Such policies, which are comparable to single premium policies, again enable the customer to invest substantial amounts of money with an insurance company.

**Typology 2: Early policy redemption, especially when uneconomic or unusually early**

This typology is a means to receive clean funds at an early stage. It is very often combined with high single premium or deposit account life insurance policies. A conspicuous fact is that some of the respective customers opted for early redemption despite uneconomic consequences. In some cases the money launderers redeem their policies very soon after purchasing them.

**Typology 3: General insurance claim fraud in insurance involving high value goods which were purchased with illicit funds**

The cases which illustrate this typology represent a general structure of criminal behaviour in the insurance sector by transferring illicit funds into clean money paid by an insurance company. It has to be kept in mind however that the prime motivation for the transaction need not be money laundering (although it could be the case that premiums have been paid using dirty money).

**Typology 4: Cash payments to purchase insurance**

Cash payments still play a certain role in insurance business. Where large cash amounts are accepted in developed markets it is usually via intermediaries.

**Typology 5: Free look periods, which allow for refunds of premiums with clean money within the contract cancellation period**

A vulnerability which relates to the easy access to products is to be seen in this specific typology. In some jurisdictions a number of life products provide the customer's right to cancel the contract within a short period of time ("15 days free look" or "cooling-off period"). The customer will then get a refund of the paid premiums with clean money.

**Typology 6: Collusion of customer intermediary and / or insurance company employees**

Several cases showed collusive behaviour between either the customer and the broker or intermediary or between the intermediary and the insurance company. The intermediaries involved accepted illicit funds and transferred them in exchange for high commissions.

**Typology 7: Third party payments of premiums**

This typology refers to the funding of insurance policies by third parties/ persons different to the policyholder who have not been subject to the regular identification procedures when the insurance contract was concluded. The source of funds and the relationship between policyholder and third party is unclear to the insurance company.
Typology 8: Risks involved in international transactions - both where this is source of business or a destination of policy payouts

International transactions exist in a variety of constructions – a rather simple pattern is the payment of premiums from a foreign bank account or the payout of policies to a foreign jurisdiction. Typologies include those with more complex transfers of money via bank accounts or cheques through different jurisdictions, which complicates the control of the (legal) source of funds by the insurance company. Other forms are foreign customers and customers domiciled abroad who seek insurance policies via domestic or foreign intermediaries. The policy payout is usually to a foreign jurisdiction.

Typology 9: Fraudulent customers, insurance companies and reinsurance companies

Cases were noticed where criminals established or took over complex corporate structures and then entered into business relationships with insurance companies to get insurance coverage. The purpose of the various commercial insurance contracts was to invest illicit funds. Sometimes this was facilitated by the fraudulent setting-up of insurance or reinsurance companies for money laundering purposes. Thus the criminals are able to invest proceeds of crimes and to apparently undertake legal business and initiate transfers of money behind the veil of an insurance company or reinsurance company.
AML Compliance for Insurance Companies in India

The primary obligation of AML compliance for Insurance companies in India emanates from the Prevention of Money Laundering Act 2002 (PMLA) and the rules made therein under. The PMLA is applicable to all financial institutions, including the insurance companies which have been made reporting entities under the PMLA.

IRDA, vide its master circular, has specified the following as part of the AML program of any insurance company in India:

Internal policies, procedures, and controls: Each insurance company has to establish and implement policies, procedures, and internal controls which would also integrate its agents in its AML program. This should also include the know your customer (KYC) processes of the insurance companies.

Appointment of a Principal Compliance Officer: The insurance companies should designate a Principal Compliance Officer under AML rules. The name of the principal compliance officer needs to be communicated to IRDA and FIU India.

Recruitment and training of employees/agents: As most part of the insurance business is through agents/corporate agents who bring in non face-to-face business relationships with the policyholders, the selection process of agents/corporate agents should be monitored carefully.

Internal control/audit: Insurance companies’ internal audit/inspection departments should verify on a regular basis, compliance with policies, procedures and controls relating to money laundering activities.

IRDA has advocated a risk-based approach for the insurance companies in order to avoid disproportionate costs and to avoid burdening of the genuine customers.

Though the AML guidelines are applicable to both life as well as general insurance businesses, the general insurance business has been exempted from applying the AML controls at the take-on stage and is required to apply them in a risk-based manner at the payout stage.

Non-compliance to the above prescribed guidelines could result in penalties, prosecution and even cancellation of licenses of the insurance companies. Insurance companies need to bear in mind that they would be exposed to significant reputation risk due to non-compliance.

Vulnerabilities of Specific Products

Certain products have been identified by IRDA as more prone to money laundering then others. They are listed below:

Vulnerable Products

- Unit-linked products which provide for withdrawals and unlimited top up premiums;
- Single premium products-where the money is invested in lump sum and surrendered at the earliest opportunity;
- Free look cancellations-especially the big ticket cases.

Products/business lines that may be exempted from the purview of AML requirements

- Stand-alone medical/health insurance products;
• Reinsurance and retrocession contracts where the treaties are between insurance companies for re-allocation of risks within the insurance industry and do not involve transactions with customers;
• Group insurance businesses which are typically issued to a company, financial institution, or association and generally restrict the ability of an individual insured or participant to manipulate its investment;
• Term life insurance contracts, in view of the absence of cash surrender value and stricter underwriting norms for term policies (especially those with large face amounts).
Challenges in AML Compliance in India

KYC Challenges

Use of agents: As already mentioned in the vulnerability analysis of the insurance sector, implementation of effective KYC measures is the key challenge due to the use of individual as well as corporate agents for soliciting the insurance business. To pin the responsibility of KYC on agents is increasingly difficult due to the conflict of interest that the channel carries.

Lack of central database: There is no central database against which the collected information can be verified. This leads to complete reliance on the copies of the documents collected by the agents for the verification of the identity of the prospective customer.

Customer profile: For an effective monitoring program, customer profile is one of the pre-requisites. Due to lack of documents which clearly indicate the customer profile and the reluctance of customers to provide personal financial information, creation of a customer profile is a huge challenge. Customers increasingly find the asking of personal financial information intrusive, often leading to misleading collection of profile data.

AML Challenges

Effective monitoring: Due to non-availability of customer data, to implement an effective transaction monitoring becomes difficult. Often the triggers are set on the profile of the customer which may itself be incorrect. This could also be due to the use of agents which may incorrectly fill the information provided.

Linking of transactions: Effective linking of multiple policies or multiple payments of different policies to one individual is difficult, due to non availability of unique ID and acceptance of premium payment in cash.

CFT Challenges

Lack of clear typologies: There is no clear typology which has emerged in terms of terrorist financing with regards to the insurance industry.

Screening against international lists: As per IRDA master circular referred above, all insurance companies need to screen the names of their customer against the terrorist lists published by the United Nations. This list contains names of international terrorist which are mostly linked to the Al-Qaeeda and the Taliban and have little or no information of the identifiers of these individuals or entities. This puts extra burden on the compliance officers of the insurance companies to close the 'false positives' which are generated as hits against these names.

Other Challenges

Product challenge: Insurance being primarily a 'push' product, it is difficult to get the customers to comply with the requirements of compliance. 'Push' means where the product has to be sold to a customer which the customer otherwise may not buy.

Competitive nature of the industry: Insurance being a highly competitive industry, there is tremendous pressure on the sales to get in the numbers. This causes the sales function to take unnecessary 'compliance' risk to meet targets.

Legacy customers: There is a huge bulk of legacy customer on whom effective KYC checks have not been conducted but whose transactions need to be monitored and CFT checks run. Not doing this leads to ineffective AML and CFT.
Recommendations

Agent KYC Score Card: A regulatory score card for each agent should be prescribed to ensure participation of each agent in the AML program. This score card should be applicable to both individual and corporate agents. This score card should be periodically reported centrally to the IRDA for any regulatory action in case of repeated violations, including permanent termination of agency.

Centralised KYC Database: Centralising the KYC procedures to one agency on the lines of mutual funds will reduce the CDD burden and improve the quality of customer profile information. This will also help reduce the costs of customer acquisition and put the insurance companies in a better position to bargain with the selling intermediaries. Another advantage of a Centralised agency is the creation of a level playing field in terms of KYC requirements.

Unique Identification for the Insurance Industry: To link the multiple policies with their policy holders, one of the important factors is the availability of a unique ID for the individuals / corporate. An immediate alternative would be the mandatory introduction of PAN (Permanent Account Number) issued by the Income Tax authorities. But to the non applicability of the requirement of PAN to a host of segments, like the Non Resident Indian (NRI) which itself are high risk, would decrease the efficacy of this identifier.

Risk-based Approach: Looking at the existence of the huge legacy of insurance policies where inadequate CDD measures have been applied, a risk-based approach should be prescribed to products and policies which have a higher money laundering risk. This would require a look up of these policies and effective identification of the policy holders.

Use of Software for Transaction Monitoring: Intelligent software applications are available specifically designed for insurance products. While selecting an application care should be taken to ensure the flexibility of such a product to ensure the adaptability of the ever developing regulatory requirements. The application should have the necessary database to support the customer profile and to add the new products. The application should be able to effectively link multiple policies to an individual and multiple individuals to a set of policies. This will help monitor transactions and initiate AML triggers at the customer or policy level. The application should also be capable of having reporting capabilities to ensure seamless compliance.

Screening Against Negative Lists and Third Party Databases: The process of screening of names of policy applicants against the list of terrorists appearing on the United Nations 1267 list should be automated and should be done prior to the acceptance of customers. This process can be embedded in the transaction monitoring application and should be undertaken as the list gets updated. In addition, insurance companies should use third party databases that are updated regularly.
Conclusion

Insurance in India has been long viewed as a tax saving instrument and risk cover in life insurance was purely incidental. The mindset continues to be the same, although the unit-linked instruments are becoming popular. The emergence of pure risk products has thus taken a back seat. Endowment products have been dominant in insurance as they provide a component of savings also.

The insurance industry in India is still nascent and constantly evolving. Post liberalization in 2000, the insurance sector has been in the growth momentum with the entry of private insurers. The market has become extremely competitive and there is a huge pressure to acquire more customers. The life insurance business is still largely dominated by Life Insurance Corporation of India.

The product 'risk' mix is constantly increasing with insurance products being bundled with a variety of investment options. The use of corporate agents has brought in an era of a more professional approach and the emergence and recognition of the segment of high net worth individuals. Due to the linking of the equity markets with insurance products, the investors are perceiving insurance more as an investment option rather than a risk mitigant.

From the AML compliance perspective, the first set of the guidelines were issued by IRDA on March 31, 2006 and the master circular was issued on November 24, 2008. Thereafter a series of guidelines have followed suit.

The increase in the single premium policies have led to the increase of the money laundering risk for this sector in India. The high turnover of agents also increases the KYC risk of the industry as a whole. This is so as a vast majority of policies are still sourced through the traditional agent route. Having said that, the insurance industry has come a long way from being completely state-owned with no requirement of KYC processes to a competitive regime where the regulatory requirements are constantly strengthening. The insurance sector was long perceived to be an avenue of tax evasions with little or no regulatory control. In the current situation, significant controls with regards to acceptance of cash and other requirements such as PAN have been implemented by IRDA.

Though the insurance sector is less vulnerable to money laundering and terrorist financing risk as compared to the banking industry, there is a constant increase in the product ‘risk’ mix and KYC risk. To bring down the KYC risk to a minimum, the need for a centralized database is fast emerging and seems to be the proverbial silver bullet for a premium hungry industry.