

Anti-Money Laundering Final Rules for Insurance Companies Issued

Introduction

On October 31, 2005, the Financial Crimes Enforcement Network ("FinCEN") issued two long-awaited final regulations that will greatly expand the anti-money laundering ("AML") recordkeeping and reporting obligations of insurance companies.

The first rule will require each "insurance company" to establish an AML compliance program that is reasonably designed to prevent the insurer from being used to facilitate money laundering or the funding of terrorist activities (the "AML Program Rule"). The second rule will require that each insurance company file Suspicious Activity Reports ("SARs") with FinCEN when it discovers potentially suspicious transactions (the "SAR Reporting Rule") (collectively, the "Rules").¹ Insurance companies must be in compliance with the Rules by May 3, 2006.

This update provides a brief overview of the Rules and their impact on insurance companies.

Definition of "Insurance Company" Under the Rules

The Rules apply to an "insurance company" or an "insurer," which are both defined as "any

person engaged within the United States as a business in the issuing or underwriting of any covered product."² A "covered product" is:

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

According to "Q&A" guidance released by FinCEN contemporaneously with the Rules (the "Q&A Guidance"), certain products typically would *not* be included in the definition of "covered product" under the Rules.⁴ These generally include:

- Group insurance products;
- Products offered by charitable organizations (e.g., charitable annuities);
- Term (including credit) life, property, casualty, health, or title insurance; and
- Reinsurance and retrocession contracts.

¹ 31 C.F.R. § 103.137 (AML Program Rule); *id.* § 103.16 (SAR Reporting Rule); FinCEN, Amendment to the Bank Secrecy Act Regulations – Anti-Money Laundering Programs for Insurance Companies, 70 Fed. Reg. 66,754 (Nov. 3, 2005) (Preamble to the AML Program Rule); FinCEN, Amendment to the Bank Secrecy Act Regulations – Requirement that Insurance Companies Report Suspicious Transactions, 70 Fed. Reg. 66,761 (Nov. 3, 2005) (Preamble to the SAR Reporting Rule).

² 31 C.F.R. §§ 103.16(a)(9)(i), 103.137(a)(9)(i).

³ *Id.* §§ 103.16(a)(4), 103.137(a)(4).

⁴ See "Anti-Money Laundering Program and Suspicious Activity Reporting Requirements for Insurance Companies: Frequently Asked Questions," available at <http://www.fincen.gov/nrfaq10312005.pdf>.

Insurance companies should carefully consider whether an insurance product qualifies as a “covered product” under the Rules. As noted above, the definition of “covered product” broadly includes “any ... insurance product with features of cash value or investment.” The Preamble to the AML Program rule provides that this definition is designed to encompass:

[A]ny insurance product having the same kinds of features that make permanent life insurance and annuity products more at risk of being used for money laundering. To the extent that term life insurance, property and casualty insurance, health insurance, and other kinds of insurance do not exhibit these features, they are not products covered by the [Rules].⁵

Exceptions to the Rules

There are two significant exceptions to the Rules. First, insurance agents and insurance brokers are specifically exempt from the definition of “insurance company” or “insurer,” and thus are not directly covered by the Rules.⁶ The Q&A Guidance notes that insurance agents and insurance brokers “are an integral part of the insurance industry due to their contact with customers” and, accordingly, “will often be in a critical position of knowledge as to the source of investment assets, the nature of the clients, and the objectives for which the insurance products are purchased.”

However, instead of requiring insurance agents and brokers to develop their own AML programs and file SARs, the Rules require each insurance company to develop and implement policies, procedures, and internal con-

⁵ Preamble to the AML Program Rule, 70 Fed. Reg. at 66,757.

⁶ 31 C.F.R. §§ 103.16(a)(9)(ii), 103.137(a)(9)(ii). An “insurance agent” is defined as “a sales and/or service representative of an insurance company,” and encompasses “any person that sells, markets, distributes or services an insurance company’s covered products, including, but not limited to, a person who represents only one insurance company, a person who represents more than one insurance company, and a bank or broker-dealer in securities that sells any covered product of an insurance company.” *Id.* §§ 103.16(a)(7), 103.137(a)(7). An “insurance broker” means “a person who, by acting as the customer’s representative, arranges and/or services covered products on behalf of the customer.” *Id.* §§ 103.16(a)(8), 103.137(a)(8).

trols “integrating the company’s insurance agents and insurance brokers into its [AML] program” and that are “reasonably designed to obtain customer-related information necessary to detect suspicious activity from all relevant sources, including from its insurance agents and insurance brokers” This places significant oversight responsibilities on insurance companies with respect to their insurance agents and insurance brokers. According to the Q&A Guidance:

The insurance company remains responsible for the conduct and effectiveness of its [AML] program, which includes the activities of the agents and brokers that are involved with covered products. The insurance company must exercise due diligence, not only in the development of its [AML] program and in the collection of appropriate customer and other information but in monitoring the operations of its program, its employees, and its agents.

Second, the Rules do not apply to an insurance company that is registered, or is required to register, as a broker or dealer with the Securities and Exchange Commission (“SEC”) to the extent that the company “is required to establish and has established an AML program ... and complies with such program,” and complies with the SAR reporting requirements applicable to broker-dealers. However, according to the Q&A Guidance, any such company “should evaluate the extent (if any) to which its existing [AML] program should be revised to appropriately address the risks of doing business in covered insurance products.”

AML Program Rule

The AML Program Rule requires each insurance company to develop and implement a written AML program “applicable to its covered products that is reasonably designed to prevent the insurance company from being used to facilitate money laundering or the financing of terrorist activities.”⁷ The AML program must be approved by senior management and made available to the Treasury Department or its designee upon request. To meet the minimum requirements of the AML Program Rule, each insurance company must:

- Develop and implement policies, procedures and internal controls;

⁷ *Id.* § 103.137(b).

- Designate a compliance officer responsible for implementing the program;⁸
- Provide ongoing training for “appropriate persons;” and
- Provide for independent testing to monitor and maintain an adequate program.⁹

An insurance company must develop and implement policies, procedures, and internal controls “based upon the insurance company’s assessment of the money laundering and terrorist financing risks associated with its covered products.”¹⁰ The policies, procedures, and controls must include provisions for complying with the insurance company’s obligations under the U.S. Bank Secrecy Act, as amended (including appropriate provisions of the USA Patriot Act).

According to the Preamble, FinCEN designed the AML Program Rule “to give insurance companies the flexibility to design their programs to meet the specific risks associated with their particular business.” These risks may come in many forms, including those related to the geographic area in which the company does business, the products or services it offers, or the clients to which it offers products and services. The AML Program Rule makes it incumbent upon the insurance company to integrate its agents and brokers into its program, collect relevant customer information from them, utilize that information to identify “red flags,” and use the knowledge it possesses about its lines of business to develop an adequate program.¹¹

⁸ The compliance officer shall be responsible for ensuring that (a) the AML program is implemented effectively, including monitoring compliance by the company’s brokers and agents; (b) the AML program is updated as necessary; and (c) training is provided to appropriate persons.

⁹ The independent tests may be conducted by a third party or an employee or officer of the insurance company, but not the insurance company’s AML compliance officer.

¹⁰ *Id.* § 103.137(c)(1).

¹¹ It should be noted that, because insurance companies are required to implement AML programs, insurance companies will be able to take advantage of the Bank Secrecy Act’s safe harbor for information sharing among financial institutions. An insurance company that intends to share information with other financial institutions about suspected money laundering or terrorist financing activity will be protected by a broad statutory safe harbor in connection with such information sharing, but only if the insurance company has filed an annual notice with FinCEN

SAR Reporting Rule

The SAR Reporting Rule requires each insurance company to file an SAR with FinCEN regarding any suspicious transactions “involving a covered product that is relevant to the violation of law or regulation.” In addition, the SAR Reporting Rule explicitly permits the voluntary filing of SARs regarding transactions not involving covered products. Similar to other SAR rules, the SAR Reporting Rule defines a suspicious transaction as one:

[C]onducted by, at, or through an insurance company, and involves or aggregates at least \$5,000 in funds or other assets, and the insurance company knows, suspects, or has reason to suspect that the transaction (or a pattern of transactions of which the transaction is a part):

- (i) Involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity ...;
- (ii) Is designed ... to evade the requirements of the Bank Secrecy Act ...;
- (iii) Has no business or apparent lawful purpose or is not the sort in which the customer would normally be expected to engage, and the insurance company knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction; or
- (iv) Involves use of the insurance company to facilitate criminal activity.¹²

The SAR Reporting Rule also requires insurance companies to report suspicious transactions conducted through its agents and brokers. Because of this requirement, it will be especially important for insurance companies to integrate their brokers and agents into their AML and SAR reporting programs, and to effectively collect and utilize customer information from their insurance agents and insurance brokers.

ance company has filed an annual notice with FinCEN availing itself of the safe harbor. *See id.* § 103.110.

¹² *Id.* § 103.16(b)(2).

According to the Q&A Guidance, insurance companies offering variable annuities and variable life insurance products will be required to file SARs, even if such products are funded by separate accounts that meet the definition of a “mutual fund” under the Bank Secrecy Act regulations. Mutual funds currently are not required to file SARs, but FinCEN is expected to soon issue a rule that requires mutual funds to file SARs. When that final rule becomes effective, FinCEN will amend the SAR Reporting Rule to ensure that suspicious activity involving variable annuity and variable life insurance products funded by “mutual fund” separate accounts are reported under the mutual fund SAR rule.¹³

Consistent with other SAR rules that apply to banks and broker-dealers, the SAR Reporting Rule generally prohibits insurance companies from notifying the person or persons involved in the suspicious activities that an SAR has been filed. Accordingly, the SAR Reporting Rule requires an insurance company to decline to produce an SAR, or provide information that tends to indicate that an SAR exists, in response to a subpoena or request unless the subpoena or request is from FinCEN or another appropriate law enforcement or supervisory agency.¹⁴ In addition, as with other SAR reporting rules, any company or person filing an SAR pursuant to the SAR Reporting Rule, regardless of whether the report is voluntary or required, is protected by a statutory safe harbor from liability arising from disclosures in the SAR

¹³ It should be noted that most separate accounts that fund variable life insurance and variable annuity contracts do *not* meet the definition of “mutual fund” under the Bank Secrecy Act rules. A “mutual fund” is defined under the Bank Secrecy Act rules as an investment company (as defined in Section 3 of the Investment Company Act of 1940, as amended (“1940 Act”)) that is an open-end company (as defined in Section 5 of the 1940 Act), that is registered, or required to register, with the SEC under Section 8 of the 1940 Act. See 31 C.F.R. § 103.131. However, most separate accounts that fund variable life insurance and variable annuity contracts are unit investment trusts, and do not meet the definition of “mutual fund” under the Bank Secrecy Act rules since they are not “open-end” companies as defined in Section 5 of the 1940 Act. The reporting of suspicious activity involving variable life insurance and variable annuity contracts funded by separate accounts that are unit investment trusts is, and will remain, governed by the SAR Reporting Rule.

¹⁴ *Id.* § 103.16(f). In the event that a request is made or a subpoena issued for an SAR or information pertaining to an SAR, the insurance company is required to notify FinCEN of the request and the insurance company’s response.

and/or the failure to produce the SAR or disclose its existence.¹⁵

Along with the SAR Reporting Rule, FinCEN has proposed and solicited comment on a new SAR form for insurance companies, Form SAR-IC. Until such time as Form SAR-IC is adopted and available for use, FinCEN expects insurance companies to use Form SAR-SF (the SAR form for the securities and futures industries). FinCEN recommends that insurance companies enter the term “Insurance SAR” in the first line of the narrative section of Form SAR-SF.

Inspections and Examinations

FinCEN or its delegate is charged with authority to inspect insurance companies for compliance with the Rules.

Compliance with the Rules

In addition to satisfying the requirements of the AML Program Rule, an adequate AML program will also ensure compliance with the SAR Reporting Rule. In this regard, each insurance company subject to the Rules should begin to develop tailored AML policies and procedures “reasonably designed to prevent the insurance company from being used to facilitate money laundering or the financing of terrorist activities.” Each insurance company should promptly designate an AML compliance officer to help design, implement, and supervise its AML program.

An insurance company also should determine what money laundering and terrorism risks exist within its covered product lines. In doing so, an insurance company should examine the jurisdictions in which it offers its products, and the individuals and entities to which it offers its products. Once an insurance company determines the types and levels of its risks, it should work with its AML compliance officer and skilled third parties, as appropriate, to develop policies, procedures, systems, and internal controls designed to ensure that the company complies with the Rules.

¹⁵ See 31 U.S.C. 5318(g)(3).

Such policies, procedures, systems, and controls should, at a minimum:

- Be customized to the individual risk profile of the insurance company, and be designed to detect and report suspicious activities;
- Ensure that the insurance company files SARs when appropriate;
- Integrate the insurance company's existing procedures for complying with U.S. economic and trade sanctions administered by the Office of Foreign Assets Control, U.S. Department of the Treasury, into the insurance company's new AML program;
- Ensure that the insurance company continues to file FinCEN/IRS Form 8300 to report the receipt of \$10,000 or more in cash and certain cash equivalents, as appropriate;
- Cause the insurance company to comply with FinCEN's "314(a) Requests" for information about persons suspected of money laundering or terrorist financing;
- Cause the insurance company to respond to actions taken by the Secretary of the Treasury regarding areas of "primary money laundering concern," pursuant to Section 311 of the USA Patriot Act.¹⁶ In the case of insurance companies that distribute their products through a captive agent network, fully integrate the company's agents and brokers into the insurance company's AML program; and
- In the case of insurance companies that distribute their products through independent agents (most of which are broker-dealers and are themselves independently subject to AML regulation), integrate these entities into the insurance company's AML program as much as possible, and consider amending dealer agreements with these agents and brokers to codify each party's respective AML responsibilities.

Finally, after the compliance date of the Rules, an insurance company should consider filing a certification with

¹⁶ See 31 U.S.C. § 5318A.

FinCEN under Section 314(b) of the USA Patriot Act that provides the insurance company with a broad safe harbor from liability when it shares information with certain other financial institutions about suspected money laundering or terrorist financing activity.

Dechert LLP continues to monitor anti-money laundering regulatory developments and will issue further updates when warranted.

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This update was authored by Keith T. Robinson (+1 202 261 3386; keith.robinson@dechert.com), Thomas C. Bogle (+1 202 261 3360; thomas.bogle@dechert.com), and Corey F. Rose (+1 704 339 3164; corey.rose@dechert.com).

Additional practice group contacts

For further information, please contact the authors, one of the attorneys listed, or any Dechert LLP attorney with whom you are in regular contact. Visit us at www.dechert.com/financialservices.

Sander M. Bieber

Washington
+1 202 261 3308
sander.bieber@dechert.com

Timothy M. Clark

New York
+1 212 698 3652
timothy.clark@dechert.com

Douglas P. Dick

Newport Beach
+1 949 442 6060
douglas.dick@dechert.com

Ruth S. Epstein

Washington
+1 202 261 3322
ruth.epstein@dechert.com

Susan C. Ervin

Washington
+1 202 261 3325
susan.ervin@dechert.com

Joseph R. Fleming

Boston
+1 617 728 7161
joseph.fleming@dechert.com

Brendan C. Fox

Washington
+1 202 261 3381
brendan.fox@dechert.com

David J. Harris

Washington
+1 202 261 3385
david.harris@dechert.com

Robert W. Helm

Washington
+1 202 261 3356
robert.helm@dechert.com

Jane A. Kanter

Washington
+1 202 261 3302
jane.kanter@dechert.com

Stuart J. Kaswell

Washington
+1 202 261 3314
stuart.kaswell@dechert.com

George J. Mazin

New York
+1 212 698 3570
george.mazin@dechert.com

Jack W. Murphy

Washington
+1 202 261 3303
jack.murphy@dechert.com

John V. O'Hanlon

Boston
+1 617 728 7111
john.ohanlon@dechert.com

Jeffrey S. Poretz

Washington
+1 202 261 3358
jeffrey.poretz@dechert.com

Jon S. Rand

New York
+1 212 698 3634
jon.rand@dechert.com

Keith T. Robinson

Washington
+1 202 261 3386
keith.robinson@dechert.com

Alan Rosenblat

Washington
+1 202 261 3332
alan.rosenblat@dechert.com

Frederick H. Sherley

Charlotte
+1 704 339 3100
frederick.sherley@dechert.com

Patrick W. D. Turley

Washington
+1 202 261 3364
patrick.turley@dechert.com

Brian S. Vargo

Philadelphia
+1 215 994 2880
brian.vargo@dechert.com

David A. Vaughan

Washington
+1 202 261 3355
david.vaughan@dechert.com

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