LOFSA

LABUAN OFFSHORE FINANCIAL SERVICES AUTHORITY, MALAYSIA

GUIDELINES ON ANTI-MONEY LAUNDERING MEASURES FOR OFFSHORE INSURANCE AND INSURANCE-RELATED COMPANIES

Introduction

1. Money laundering refers to any techniques, procedures or processes undertaken to legitimise funds derived from illegal or criminal activities and to conceal the origins of proceed of criminal activity. Financial institutions including insurance companies are major targets of money-laundering operations because of the variety of services and investment vehicles offered that could be used to conceal the source of money.

2. Money laundering poses significant reputational and financial risk to insurance companies, as well as the risk of criminal prosecution if insurance companies involved in laundering of the proceeds of crime. To combat money laundering, insurance companies should adhere to the following:

   a. Comply with anti-money laundering laws;
   b. Implement "Know Your Customer" policy;
   c. Cooperate with law enforcement authorities, insurance supervisors and other investigative and supervisory authorities; and
   d. Have in place anti-money laundering policies, procedures and a training program.

Scope

3. These guidelines apply to all offshore insurance and insurance-related companies licensed under the Offshore Insurance Act 1990. These guidelines provide minimum standard on duty of vigilance to be practiced by all licensees. Where the licensees are subject to more stringent requirement imposed by their home supervisor, they are required to comply with the requirements of their home supervisor.

4. All measures in these guidelines are to be read together with all legal aspects of the Anti-Money Laundering Act 2001 (AMLA) wherever applicable. All licensees should observe, report and comply with the requirement of these guidelines as well as the requirement under AMLA.

5. Licensees with the group policies on anti-money laundering measures must apply to all branches and/or subsidiaries in the group including offices outside Labuan.

Stages of Money Laundering

6. There are three stages of money laundering:

a. **Placement**

In the initial or placement stage of money laundering, the criminal introduces his illegal profits into the financial system. This is the physical disposal or dealing of the initial proceeds derived from illegal activities.

b. **Layering**

It is the process of separating the criminal proceeds from their source by creating complex layers of financial transactions designed to disguise the audit trail and provide an appearance of legitimacy.

c. **Integration**

It is the stage after the criminal proceeds have been successfully laundered. The integration places the criminal proceeds back into the financial system in such a way that they appear to be legitimate funds or assets.

Form of Money Laundering

7. Within the insurance system, money launderers may structure transactions, coerce employees to co-operate and not to file proper reports, or establish apparently legitimate front insurance licensees to launder money.

a. **Life insurance business**

The most common contracts used for laundering money are "purchase of single premium investment policies such as investment-linked single premium contracts, annuities, lump sum top-ups to existing life insurance contracts or lump sum contributions to personal pension contracts.

b. **General insurance business**

Money laundering can be seen from bogus claims, where money launderers purchase legitimate business, then by arson or other means cause bogus claims to recover part of their investment. Another form is through the use of reinsurance.

The Duty of Vigilance

8. The International Association of Insurance Supervisors (IAIS) has promulgated that the insurance licensees should be constantly vigilant to avoid assisting the process of laundering funds derived from crimes. The duty of vigilance consist mainly the following elements:

a. Underwriting checks;
b. Verification of identity;
c. Recognition and reporting of suspicious customers/transactions;
d. Keeping of records; and
e. Training of relevant personnel.

9. Thorough underwriting will enable insurance licensees to understand the business written. Underwriting will include checking the presence of insurable interest when accepting applications and processing claims.

10. An anti-money laundering program must enable insurance licensees:

a. To foster close working relationships between underwriters and claim investigators;

b. To determine (or receive confirmation of) the true identity of prospective policy owners. The insurance licensees must establish a manual on "Know Your Customer" policy;

c. To recognise and report suspicious transactions to the relevant authority;

d. To keep records for the prescribed period of time. All record must be maintained for at least six years;

e. To train staff, including intermediaries. Staff must be qualified as the fit and proper person for their roles;

f. To liaise closely with law enforcement authority on matters concerning vigilance policy and systems;

g. To ensure that internal auditing and compliance departments regularly monitor the implementation and operation of vigilance policy and system;

h. To ensure compliance with relevant regulations by establishing a system of internal control;

i. To establish high ethical standards in all businesses and require compliance with laws and regulations;

j. To ensure cooperation with law enforcement authorities, within the confines of applicable law;

k. To establish a system of procedures, controls and reporting system to be complied by all related staff. Such system should be reviewed regularly for relevance and effectiveness; and

l. To draw up manuals detailing the due diligence process and procedures in terms of all policies and the procedures to ensure the effective implementation of the insurer's anti-money laundering measures.

Anti-Money Laundering Framework

11. The framework aims to provide a set of transparent, explicit and clear policies, procedures and controls to guide the insurance licensees to implement and enforce effective anti-money laundering measures. The components of the framework are as follows:

a. **Verification**

Insurance licensees should verify and be satisfied with the identity of their customers and the nature and legitimacy of the insurance transactions to be undertaken. The consideration when verifyng are as follows:

i. **Subject of verification**

- Insurance licensees undertaking verification should establish to its reasonable satisfaction that every subject of verification relevant to the application for insurance business actually exists. The verification process should not only focus on the parties directly involved to the policies but indirect or related parties as well.
- If claims, commissions and other monies are to be paid to persons other than the policy owner then the proposed recipients of these monies should be the subject of verification.
- Any reinsurance on retrocession needs to be checked to ensure the monies are paid out to *bona fide* reinsurers for rate commensurate with the risks underwritten.

ii. **Method of verification**

- There must not be reliance on single documentary evidence. The best possible evidence could be the most difficult to replicate or acquire lawfully because of its reputable and/or official origin.

- The licensee must obtain and keep a copy of the relevant documents evidencing the identity of the party concerned. Where necessary, such documents are to be checked with the relevant issuing authority.
- The method of verification should not be unduly influenced by the type of policy being applied for.
- The findings of the verification exercise should be conclusive, before any policy is contracted. If the transaction is concluded before the completion of the verification exercise for sound business reason, the insurer should ensure no claims or surrender value are paid out prior to the conclusion of the verification exercise.
- Examples of documentary evidence are listed in **Appendix I**. These examples are not intended to be exhaustive.

iii. **Exempt cases**

Although the cases given in **Appendix II** are exempted from verification, the Insurance licensees must continually be vigilant and be guided by the fact that where it knows or has reason to believe or suspects that money is being laundered, or that money laundering is, may or has occurred, the exemptions are no longer applicable.

iv. **Results of verification**

- **Satisfactory**

  Once verification has been completed (and subject to the keeping of records in accordance with this Guidelines) no further evidence of identity is needed when transaction are subsequently undertaken.

- **Fails**

  If the verification indicates that the identity is not true or misleading representations were made or source of funds are not justified, the proposed transactions should not be executed and should be treated as suspicious. A report of suspicious transaction must be made to LOFSA. Funds should never be returned to a third party but only to the source where they came.

b. Recognition and Reporting of Suspicious Customers / Transactions

i. Recognition of suspicious customers/transaction

- All insurance licensees must observe the "Know Your Customer" policy. This will enable the insurance licensee to create a profile in terms of economic/financial background of a customer. It will be use as a tool to vigilantly monitor the financial flows and transaction patterns of existing policy owners, particularly where there is a significant, unexpected and unexplained change in the behaviour of an account.
- Examples of suspicious transactions are listed in **Appendix III**. These examples are not intended to be exhaustive.

ii. Reporting of suspicious customers/transactions

- Insurance licensees are required to institute a formal system of reporting of suspicious transactions and document in a manual and to make this manual accessible to all relevant staff. The procedures of the reporting system should minimally incorporate the following features:
  - A compliance officer is to be appointed - all suspicious transaction are to be reported to and monitored by the compliance officer.

- The procedure of reporting and maintenance of documents and records pertaining to the suspicious transaction must be drawn out clearly.
- A compliance officer or any other authorised person is responsible to report such transaction to LOFSA.
- Where a further investigation of the customer is required following the reporting of a suspicious transaction to LOFSA, care should be taken to ensure that the customer is not aware that such a report has been made to LOFSA.

iii. Reporting to the Board of Directors (Board) and Senior Management

In order to enhance corporate governance among insurance licensees, the Board must be kept informed of the suspicious transactions reported to LOFSA and actions taken by the insurance licensee.

c. Keeping of Records

i. Contents of records

- Verification records should contain:
  - A description of the nature of all evidence received relating to the identity of the policy owner; and
  - The evidence itself or a copy of it or if that is not available, information reasonably sufficient to obtain such copy.

- Transaction records should contain:
  - Details of personal identity including the names and addresses of the policy owner and other parties connected to insurance contract; and
  - Details of transactions including the nature of transactions, contract price(s) and valuation (in the case of investment-linked policies), destination(s) of funds, memoranda of

instruction and authority, book entries, the date of the transaction and the form in which funds are offered and paid out.

- All records should be in readily retrievable form and accessible without undue delay. A retrievable form may consist of an original hard copy, microform or electronic data.
- Records held by third parties are not in a readily retrievable form unless the institution is reasonably satisfied that the third party is itself an institution which is able and willing to keep such records and disclose them to it when required.

ii. Register of enquiries

- An insurance licensee should maintain a register of all enquiries made by the law enforcement authority. The register should be kept separate from other records and contains as a minimum the following details:
  - The date and nature of the enquiry;
  - The name and agency of the enquiring office;
  - The powers being exercised; and
  - Details of policies involved.

d. Training

i. All insurance licensees must ensure that proper training is in place for staff. The training must include issues on customer due diligence, detection of money laundering, obligations under anti-money laundering framework and the relevant guidelines. The training programmes must be continuous to ensure the staff are exposed to recent issues and trends of money laundering as well as new legislative or non-legislative requirements by supervisory authority.

ii. All relevant staff (i.e. front-line staff, advisory staff, underwriting/processing and claims-handling staff) must have basic understanding of money laundering activities and their legal obligation under the guidelines to detect and report suspicious transactions. Ongoing monitoring of the customer's account and transaction must be conducted all the time.

iii. Compliance officer is required to have in-depth knowledge and conversant with methods and detection of money laundering. The officer must understand the requirements of the AMLA and such guidelines issued by LOFSA.

iv. A higher level of briefing encompassing all aspects of the guidelines, vigilance policy and systems should be provided to key personnel responsible for supervision and management of staff.

Implementation

12. The guidelines shall be observed by all offshore insurance and insurance-related companies with immediate effect.

Labuan Offshore Financial Services Authority
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Appendix I

EXAMPLES OF DOCUMENTARY EVIDENCE

Individual

1. Personal information to be considered shouid include:
   a. Full name(s) used;
   b. Date and place of birth;
   c. Nationality;
   d. Current permanent address;
   e. Telephone number;
   f. Fax number;
   g. E-mail address;
   h. Occupation and name of employer (if self-employed, the nature of the self-employment); and
   i. Specimen signature of the verification subject.

2. Some documents that may be considered the best possible to verify the above particulars of the individual are current valid passport, national registration identity card, armed forces identity card and driving licence that bear a photograph.

3. Other documents that may be considered with some degree of care for the purpose of verification are birth certificates, an identity card issued by the employer of the applicant and credit cards.

Companies, partnerships and other institutions

1. Partnerships and any other institutions (including clubs, societies and charities), verification must be made on the individuals acting on behalf of the entity and the company secretary of the entity should duly accredit all entity signatories.

2. Care should also be taken when using the following documents for verification such as:

   a. Certificate of incorporation;

   b. The name(s) and address(s) of the beneficial owner(s) and/or the person(s) on whose instructions on the account are empowered to act, constitutional documents, e.g. Memorandum and Articles of Association, Powers of Attorney or other authorities given by the entity;

   c. Latest report and accounts, where possible, to establish the authenticity of the business; and

   d. A signed statement as to the nature of the business and where appropriate information should be sought from another Institution.

3. Particular attention may be necessary to verify the origin of these documents and the background against which they are produced. The originals or certified copies of certificates should be produced for verification.

Appendix II

EXAMPLES OF EXEMPT CASES

1. Where it is a **switch** and all the proceeds of a significant one-off transaction are paid directly into another insurance policy which itself can, on subsequent surrender, only result in either:
   a. A further premium payment on behalf of the same customer; or
   b. A payment being made directly to the customer and of which a record is kept.

2. Where payments of one policy are used to fund premiums payable in another policy for the **same customer.** This is not regarded as entry into a business relationship, and as such do not require verification.

3. Where **third party evidence is required to support the exemption**. Here, the introducer of the customer is a reliable party and submits a written introduction. This introducer may be:
   a. A reliable local institution, which is subsequently verified by the insurance entity and supplemented by appropriate enquiries, where necessary.
   b. A professionally qualified person or an independent financial adviser operating from an acceptable jurisdiction, and whereby the insurance licensee is satisfied that the rules of his/her professional body regulator include ethical guidelines which together with the money laundering laws and regulations in his/her jurisdiction include requirements at least equivalent to those in the guidelines.
   c. Where the introducer is reliable and has good standing introduction.
   d. Where the introducer is either an overseas branch or member of the same group as the receiving insurance licensee.

Details of the introduction should be kept as part of the records of the customer introduced.

A critical condition for the acceptability of such an introducer is that the terms of business between the insurance licensee and the introducer should require the introducer to complete verification of all customers introduced to the insurance licensee or to inform the insurance licensee of any unsatisfactory conclusion in respect of any such customer, to keep records in accordance with the Guidelines and to supply copies of any such records to the insurance licensee upon demand.

4. Where **third party evidence is not required** to support the exemption:

   a. Where the customer is a licensed and/or supervised financial institution.

   b. Where there are small one-off applications, unless between entry and termination it appears that two or more one-off transactions are in fact linked and constitute a significant one-off transaction. In the absence of any contrary evidence, a period of three months or more of separation between one-off transactions are deemed as not linked.

   c. Where payments are made through post, credit card or electronically such as through the Internet, and such mode of payment is regarded reasonable, and where payment is from the customer's account held in another institution which is registered/ authorized/ exempt under local insurance (and banking) laws, the name(s) of the customer for business corresponds with the name(s) of the customer for business corresponds with the name(s) of the paying account holder, the receiving insurance licensee keeps a record of the customer's account with that other institution and there is no suspicion of money laundering. In such cases, it may be assumed that the other institution has completed the necessary verification.

EXAMPLES OF SUSPICIOUS TRANSACTIONS

General Comments

The list below shows some basic ways that money can be laundered in the insurance industry. It is to be noted that each transaction may or may not be sufficient to suggest that money laundering is taking place whilst a combination of such situations may also allude to such a transaction.

Brokerage and Sales

1. **New Business**
   a. A customer for whom verification of identity proves unusually difficult. The customers evades full disclosure or reluctant to provide full details.
   b. A corporate/trust customer where there are difficulties and delays or difficulties in obtaining copies of the accounts or other documents of incorporation.
   c. A customer with no discernible reason to use the insurer's service, e.g. customers with distant addresses who could find the same service nearer their home base, or customers whose requirements are not in the normal pattern of or inconsistent with the insurer's business or could be more easily serviced elsewhere.
   d. A customer introduced by an overseas broker, affiliate or other intermediary, where both customer and introducer are based in countries where production of drugs or drug trafficking may be prevalent.
   e. Any transaction in which the insured is unknown (e.g. treaty reinsurance, business introduced under binding authorities, etc.).

2. **Abnormal Transactions or which do not make economic sense**
   a. Proposals from an intermediary not a normal business introduced.

b. Proposals that are inconsistent with an insured's normal requirements; the markets in which the insured or intermediary is active and the business that the insured operates.

c. Early cancellation of policies with return of premium, with no discernible purpose or in circumstances which appear unusual.

d. A number of policies entered into by the same insurer/intermediary for small amounts and then cancelled at the same time, the return of premium being credited to an account different from the original account.

e. Any transaction in which the nature, size or frequency appears unusual, e.g. early termination or cancellation, especially where cash has been tendered and/or the refund cheque is to a third party or a sudden purchase of a lump sum contract from an existing customer whose current contracts are small and of regular payments only.

f. Assignment of policies to apparently unrelated third parties.

g. Transactions not commonly practiced in the market to which they relate, e.g. with reference to size or class of business.

h. Willingness to pay premium on high risks that have a likelihood of regular claims being made.

Settlement

1. **Payment**

a. A number of policies taken out by the same insured for low premiums, each purchased for cash and then cancelled with return of premium to a third party.

b. Large or unusual payment of premiums or transaction settlement by cash.

c. Overpayment of premium with a request to refund the excess to a third party or to an account opened in a different country.

d. Payment by way of third party cheque or money transfers where there is a variation between the account holder, the signatory and the prospective insured.

2. **Disposition**

a. Payment of claims to a third party without any apparent connection to the policy owner.

b. Abnormal settlement instructions, including payment to apparently unconnected parties or to accounts in countries in which the insured is not known to operate.

3. **Claims and Reinsurances**

a. Strong likelihood of risks occurring, resulting in substantial claims, with consequently high premium.

b. Claims paid to persons other than the insured.

c. Claims which, while appearing legitimate, occur with abnormal regularity.

d. Regular small claims within premium limit.

e. Treaty reinsurances with high incidence of small claims.

f. Regular reinsurance claims paid overseas to third parties.

g. Recent change of ownership/assignment of policies just prior to a loss.

h. Abnormal loss ratios for the nature and class of risk bound under a binding authority.