SymphonyAI
SENSA-NETREVEAL

WHITE PAPER

Compliance for Insurance

It's not about the Fines!



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By Trevor Barritt, November 2023

It's all about the risks

If there is one industry that understands risk, it is the insurance sector. But what are the real risks of money laundering to the individual insurance company? Currently, they are as follows:

- **Fines –** A principal risk to any insurance company is criminal and regulator enforcement action if breaches of regulations are detected or if money is laundered.
- **Opportunity Cost –** For every published fine, there are dozens of other cases at other firms which the regulator investigates. For insurers and other regulated entities, resources spent in dealing with an enquiry are huge, often running into thousands of man-hours across many different departments. Sometimes, external lawyers and consultants are needed and the cost to the firm of dealing with a regulatory breach is often far greater than any potential fine, particularly when considering the opportunity costs of senior revenue earners' time diverted to defending the company.
- **Civil Suits –** In numerous countries, if a plaintiff can demonstrate that the funds they lost were laundered through a financial institution, and that the institution should have reasonably detected this, the institution is obligated to compensate the plaintiff for damages, regardless of whether the funds have already been withdrawn. This legal principle was first established in a UK Privy Council case where criminals washed €9,500,000 – proceeds from stolen art, and the court held that the plaintiffs were able to get full compensation from the financial institution concerned. Supreme courts around the world have followed this decision making since then, the latest case being in Switzerland in 2023[1].
- **Criminal Liability –** There are three main issues. While the laws of the United Kingdom will be used below, the laws in other major countries are the same as far as the points raised are concerned.
  - **Involvement in money laundering –** Anyone involved in any arrangement whereby the proceeds of crime are transferred, hidden, used, etc. commits an offence if they know or suspect that the funds are the proceeds of crime. This applies to employees and their employer.
  - **Failure to report –** The law distinguishes between two types of suspicion: subjective and objective. Subjective suspicion occurs when a person actually suspects something amiss. If a person goes ahead with the transaction after such suspicion forms, they are guilty of money laundering. Objective suspicion occurs when they do not suspect. If later, a court, with hindsight, rules that a person working for an insurance company should have suspected wrongdoing, and didn't (and therefore didn't report it), they can go to prison for up to 5 years despite believing to have acted honestly throughout.
  - **All claim fraud is money laundering –** The definition of money laundering includes possession and use of the proceeds of crime. One cannot commit claim fraud without someone being in possession of and using the proceeds. Therefore, every case of claim fraud is automatically money laundering and failure to report it can result in anyone working in the financial services sector risking up to 5 years in prison. Technically, those working in motor/building/ professional liability insurance, etc. fall outside the Money Laundering Regulations but His Majesty's Revenue and Customs (HMRC) in the UK has issued guidance on this point in the context of real estate[2]. In the UK, lettings contracts are only covered by the Money Laundering Regulations if the monthly rent is at least €10,000 per month. However, according to HMRC guidance, if a corporate entity has at least one such premium level rental on its books, all rental activity will qualify as being undertaken by a company in the regulated sector. Although these guidance notes are in relation to real estate, if regulated and unregulated business occurs together in the same company, the legal principle remains. If a court were to follow the HMRC Guidance in an insurance context (and there is good reason to believe that it would) then if the same insurance company has at least one life policy, then all policies would be covered. This does not appear to have been tested in court though a UK judge would surely be guided by it. The highest authority on this point is therefore the HMRC Guidance, which is likely to be followed in other countries if previous experience is anything to go by[3].

Most of the above cases have occurred since 2021, with the original floodgates case occurring in 2015. Given that they are mainly tucked away out of the headlines, it may be that many insurance companies are not aware of some or all of them. This should be a wakeup call for insurers that their current assumptions may not be correct, at least in the future.

To understand if your company is at risk of falling foul of regulations, we will explore AML in an insurance context more closely and look at, areas that might need regulation, and how best to enact anti-money laundering (AML) solutions around the world.

[1] Swiss Supreme Court, decision 6B_1202/2019, E. 4.2.2
[2] Estate and letting agency business guidance for money laundering supervision - GOV.UK (www.gov.uk)
[3] Of course, in many cases such consequences are defeated by non-life and life business being conducted in separate corporate entities, but the principle remains.

How money is laundered in insurance (and where is it regulated)

In most countries, the only type of insurance covered by money laundering regulations is life insurance (together with some narrowly defined associated products). The reasons for this appear to be that regulators accept that money laundering risk in non-life policies (such as motor vehicle, housing, etc.) are so low as not to be worth placing a regulatory burden of matters such as Customer Due Diligence (CDD), transaction monitoring, Suspicious Activity Reporting (SAR), etc., on insurance companies.

Though this is seen around the world, an excellent explanation of this position can be seen in the Insurance Council of New Zealand response[4] to a consultation issued by the New Zealand Government review of its AML laws in 2021[5]. New Zealand chose not to extend its money laundering regulations to cover non-life insurance, but their interest in issuing a consultation paper on this point shows that times are changing. This means that one of the 38 full FATF Member Institutions, tasked with the responsibility of leading the international standards in AML believes that this might be a good idea. Specialist areas of government (such as AML) talk to one another and attend conferences together. It is not at all unlikely that other jurisdictions will now also consider consultations in future.

Maintaining the status quo

Those who wish to maintain the status quo have shown strong reactions to even the slightest suggestion to the contrary. The New Zealand Ministry of Justice Consultation Paper[6] is mild in its suggestions in this area, stating: is mild in its suggestions in this area, stating:[7]

> ***Only businesses which issue life insurance policies currently have obligations under the Act, as is required by the FATF. However, insurance companies which provide other insurance policies may be in a position to identify suspicious activity or behaviour, such as potential or actual frauds. Insurance policies can also be vulnerable to money laundering, for example where a customer makes an overpayment or requests a refund shortly after purchasing a policy. Insurance fraud can also be used for money laundering, e.g., where a person insures a valuable item which is stolen or destroyed by an accomplice.***
>
> ***Including non-life insurance businesses in the Act could address money laundering vulnerabilities and provide a useful source of financial intelligence. We could also tailor the obligations of non-life insurers to ensure they are in line with the particular risks and vulnerabilities we have identified by, for example, only requiring non-life insurers to monitor accounts and report suspicious activity."***[8]

The thinking of the consultation paper appears sound in its consideration of extending regulation to non-life areas. Yet the Insurance Council of New Zealand talks about 'minimal risk' of money laundering in non-life insurance and predicts a series of calamities if the New Zealand Government were to bring such insurance into AML regulation, including:

- Unhelpful and very costly diversion away from areas which pose significant harm
- Creation of more cumbersome onboarding and claims processes
- Negative impact on insurance uptake and availability

[4] 132.insurancecouncilofnz.pdf (justice.govt.nz)
[5] Changes to AML/CFT Act regulations | New Zealand Ministry of Justice
[6] MISSING FOOTNOTE
[7] amlcft-statutory-review-consultation-document.pdf (justice.govt.nz)
[8] Ibid Page 26

The second example of a strong reaction is in response to the application paper of the International Association of Insurance Supervisors (IAIS) in November 2021[9]. This paper makes no reference to non-life insurance apart from some instances in the appendices of real-life case studies. These contain 25 examples of money laundering, of which two are non-life (reinsurance and financial risk respectively), and four examples of terrorist financing, of which two are non-life (motor and jewelers' block respectively).

Industry reaction to this paper has been extreme. Insurance Europe's response[10] is concerned that the paper does not specifically specify life assurance each time that it mentions insurance in a money laundering context, and seeks to brand the small number of non-life examples as irrelevant, untrue or (in one case) relating more to fraud than money laundering (see above for why insurance fraud is always money laundering).

It is understandable that an industry's professional associations wish to protect their members against unnecessary regulation and red tape, but some industry reactions to relatively mild suggestions from recognized authorities appear to be overwrought.

Both India and Taiwan, for example, have extended the coverage of their money laundering regulations to at least some areas of general insurance but they are in a small minority. The vast majority continue to primarily focus on life insurance policies as part of their current AML obligations rather than extending this approach to non-life policies as well.

The case for regulating non-life insurance

There are a few supporters of promoting extension of money laundering regulation to the area of non-life insurance, among them the IAIS (though not explicitly promoting extension to non-life, they do incorporate a small number of non-life examples in the appendix of the application paper referred to above and 'Examples of money laundering and suspicious transactions involving insurance'[11]). Also, the fact that all claim fraud is money laundering would suggest there is at least a case to be heard and listened to with more of an open mind.

Firstly, money laundering control is much more than ticking a box to keep the regulator away. It can have profound positive effects on a financial institution's bottom line, its retention of its license, the liberty of its staff, and the efficiency of its business.

Secondly, the fact that non-life business is not regulated for money laundering purposes in most countries does not mean that money laundering risks can be ignored in this sector despite some industry quotes that non-life insurance represents a 'very low risk or 'no risk' of money laundering.

A large building or group of buildings, a fleet of ships, etc. can be insured for a large single premium which is then nearly all repaid shortly thereafter. Even with a policy on a car, it is not necessary to prove ownership of the assets insured.

A more effective way of money laundering in motor insurance is the fraudulent claim, putting the money launderer in an ideal position not afforded by most other sectors of the financial services industry – that of making a substantial profit while at the same time laundering the proceeds of crime.

Insurance requires a specific approach

Insurance companies are very different from banks and broker dealers.

When an insurance company makes the statement "insurance is a different industry with different needs", it normally means that its products are completely different from other financial services. It has no accounts as such. It does not take deposits. It hardly ever handles cash, and so on. This reminder from the insurance company is undoubtedly to make the vendor understand that a one size fits all approach based on a retail banking AML solution will not do.

Red flags in the insurance industry are different. There is little use for detection scenarios that handle excess cash, flow through of funds, and structuring. The insurance industry has its own red flags, such as early surrender and change in beneficiary, as well as a different data structure.

But the differences go wider and deeper than this. It is not just a question of having different red flags for the insurance business. The number of individual red flags in the insurance industry that are in and of themselves suspicious is far fewer than those in

[9] 211111-Application-Paper-on-Combating-Money-Laundering-and-Terrorist-Financing.pdf (iaisweb.org)
[10] https://insuranceeurope.eu/news/2390/iais-paper-must-reflect-generally-very-low-risk-of-money-laundering-and-terrorist-financing-in-non-life-insurance
[11] www.amnet.co.il/attachments/iais_examples_money_laundering.pdf

banking, brokerage, etc. Structuring is usually suspicious per se in the absence of mitigating factors. There are not many good reasons why vast sums of money might flow through an otherwise normal retail account. A purchase of a security at a price substantially different from that prevailing in the market for a similar size transaction in the same security, and a series of wash trades, are almost always of interest.

Not so with insurance. There are many good reasons why one might terminate a policy early. They might have sold the asset insured or found a better quote from a competitor. In the case of life insurance, they may have fallen on difficult financial circumstances making insurance no longer affordable. Similarly, lump sum top-ups are not so suspicious in and of themselves. Thus, whereas false positives are a major problem in all sectors of the financial services industry, they are significantly more problematic in insurance.

Another problem with detection of money laundering in the insurance industry is the relative paucity of red flags themselves. While there are dozens of such indicators in banking, investment business, gambling, trade finance, etc., one can count the red flags that apply only to insurance on two hands. Insurance money laundering is much less predictable as a set of pre-determined scenarios. Rather, detection of suspicion in the insurance sector is more a matter of combinations of different risk indicators: risk of the product, client, jurisdiction, and so on. To use an analogy, Suspicious Activity Monitoring for retail banking is closer to a finger food buffet of individual typologies, whereas for insurance, particularly life insurance, it is more akin to baking a cake with many different ingredients merged into one. A problem with this is that red flag-based rules operate in silos and are not good at blending risk factors.

A further difference in the insurance market is the difference in activity by region. Whereas there is some degree of geographical trend in other areas of the financial services market, these are not so marked as in insurance.

For example, the UK is the 4th largest long-term savings industry and largest in Europe[12] while the US National Library of Medicine found "that local culture has significant influences on life insurers' behavior".[13]

Other examples include the well-known preference in France for investing in Life Assurance Wrappers – a trend so marked that HSBC has recently published a brochure with the title "Life Insurance Wrappers. The favourite investment of the French"[14]. Alongside this, French motor insurance policies automatically renew whereas those in the UK do not[15]. As a rule, early redemption of life policies for money laundering purposes occurs much earlier in the lifetime of the policy in the UK than elsewhere in Europe.[16]

Finally, national legislation plays a huge part in regional differences. In Germany, a law allows for compensation for psychological suffering by surviving dependants of motor accidents. Motor insurance premiums in the UK are by far the highest in Europe even when adjusted for purchasing power parity[17]. In the early 1990s, when AIDS was not a treatable disease, a few European countries introduced a scheme where AIDS patients with life insurance were able to claim a percentage of the sums insured while still alive but in the advanced stages of the disease in order to assist with medical care and subsistence costs. This led to marked changes in life assurance behavior in young men in some major European cities[18].

There are many more examples. Such variations, particularly when they are unexpected such as the AIDS case, or the new Latvian law that came into force in 2014 with the effect of increasing motor claims 14-fold[19], make rule writing next to impossible, as there are too many variations and unexpected developments. Rules require stability and predictability to work.

The result is a perfect storm – substantial variation of activity based on multiple factors, a relatively small number of stable recognised red flags, constant change, products which vary enormously between themselves, and a smorgasbord of risk factors which regulators expect insurance companies to take account of in combination with each other, which as we saw above, is very hard for rules to do.

[12] abi_key_facts_2021.pdf
[13] Local religious beliefs and insurance companies' risk-taking behaviour - PMC (nih.gov)
[14] hsbc-brochure-assurance-vie-english.pdf
[15] Gleaned from discussions with colleagues in Europe
[16] Ibid
[17] European Motor Insurance Markets - February 2019 (insuranceeurope.eu) at Page 16
[18] Empirical evidence from the author's employment at the UK regulator
[19] European Motor Insurance Markets - February 2019 (insuranceeurope.eu) at Page 16

What is the solution?

There are particular needs of insurance companies that are not found, or found to a much lesser extent, in other financial services industry sectors. Therefore, a series of products specifically designed for the insurance industry is needed to address them.

The first, and most obvious step towards a solution, is to follow the regulations applicable in the countries in which one does business. In the case of global firms, this might include those such as India and Taiwan, possibly necessitating a unified global AML policy which must default to the highest standard and therefore cover non-life business. This requires sound policies and procedures in such areas as CDD, Watch List Management, Suspicious Activity Monitoring, SAR filing, training, etc., the requirements of which are available from regulators' websites.

The second step is more difficult as less specific guidance is offered in this regard – that of examining the money laundering risks of the organization with an open mind, unfettered by adherence to convention and following what has been done before. In one sense, this is no more than following regulations, as insurance companies are required to undertake a risk assessment of their business. This needs to incorporate such questions to companies as:

- What are the risks across all business lines, not just the regulated ones, of the company or an employee deliberately, recklessly or negligently involving themselves in money laundering?
- Is there sufficient connection between fraud and AML departments, given the substantial overlap between the two risks?
- To what extent should non-life business be monitored (even if it is not regulated where business is conducted) and how will that mirror or differ from the company's current life insurance monitoring?
- What, if any, risks have been overlooked in concentrating only on following regulations?

The SymphonyAI Sensa-NetReveal solution

SymphonyAI Sensa-NetReveal solutions are written by subject matter experts and data scientists who have decades of hands-on experience of AML, including in the insurance industry. The software combines supervised, semi-supervised and unsupervised machine learning models and a comprehensive suite of out-of-the-box rules.

The models are self-training and successfully undertake surveillance across hundreds of data features, thereby addressing the silo issues. The unsupervised models are uniquely placed to discover previously unknown and unimagined new ways of insurance money laundering by combining state-of-the-art profiling with leading anomaly discovery techniques. This combines with supervised models which look at risk similarity between activity observed and feedback from analysts from previous alerts.

Machine learning is uniquely able to address insurance specific issues such as the jurisdictional variations explored above, which are too complex for rules to address. In order to cover such matters efficiently, the SymphonyAI Sensa-NetReveal approach of combining supervised, semi-supervised and unsupervised Machine Learning along with rules is the only effective approach.

Machine learning is rapidly becoming the standard expected by regulators. When one examines regulatory disciplinary cases (in money laundering and other areas, in insurance and other sectors), criminal prosecutions, and civil restitution cases, one key theme emerges. Adherence to the best standards and practices available is a sure-fire way of avoiding unwanted consequences.

About SymphonyAI Sensa-NetReveal

SymphonyAI Sensa-NetReveal, a division of SymphonyAI, provides leading AI-based financial crime detection software.

Contact us to learn how SymphonyAI Sensa-NetReveal can help drive more effective financial crime detection and prevention in your company.

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