LLOYD'S

MARKET BULLETIN

FROM:	Sean McGovern, Lloyd's MLRO	EXTN:	6142
DATE:	3 November 2005	REF:	Y3661
SUBJECT:	**Money Laundering**		
SUBJECT AREA(S):	Legal framework and practical guidance		
ATTACHMENT(S):			

ACTION POINTS: **To Note**

Purpose of the Bulletin

This bulletin replaces Bulletin Y3122, and sets out the following information which should be noted by Lloyd's underwriting agents:

1. Legal and regulatory framework
2. Developments in money laundering regulation
3. General guidance on money laundering procedures
4. Guidance on spotting suspicious transactions in the insurance industry
5. Sources of Information on money laundering

This Bulletin is also sent to Lloyd's brokers for information purposes.

Background

The traditional (and widely accepted) view of the money laundering risk facing the general insurance industry is that it is significantly lower compared to other financial sectors, such as banking.

However, *lower risk* does not mean *no risk,* and at Lloyd's we have received a number of suspicious transaction reports detailing attempted insurance placements which, had they been successfully completed, could have caused serious harm to Lloyd's, both financially and in terms of reputational damage. Indeed, it is possible that the insurance market in general might be perceived as a "soft target" when compared with other financial sectors, which have traditionally imposed tight AML procedures.

It is essential, therefore, that managing agents are aware of the money laundering risks to which their businesses are exposed and ensure that they have procedures in place to address these risks and, importantly, to ensure compliance with the applicable anti-money laundering legislation and regulation.

Underwriting agents also should be alive to the requirements of the FSA rules which stipulate that firms should take reasonable care to establish and maintain effective systems and controls for countering the risk that the firm might be used to further financial crime (SYSC 3.2.6 R).

The attachments to this bulletin are aimed at providing a useful summary of the existing legal and regulatory framework in relation to money laundering, developments in this framework together with guidance on procedures and how to spot suspicious transactions.

Lloyd's is happy to provide assistance to underwriting agents on matters relating to money laundering and financial crime. Lloyd's is also happy to assist underwriting agents by providing general training presentations, which might form a useful part of an agents' overall training initiatives. Contact details are set out below.

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1. *Legal & Regulatory framework*

Proceeds of Crime Act 2002 (PoCA)

The provisions in Part 7 of PoCA replaced provisions on money laundering contained in the Drug Trafficking Act 1994 (sections 49-52) and the Criminal Justice Act 1988 (sections 93A-93D). PoCA consolidated this legislation and unified it by replacing the parallel drug and non-drug criminal laundering offences with single offences that do not distinguish between the proceeds of drug trafficking and other crimes.

PoCA created a single set of money laundering offences applicable throughout the UK to the proceeds of all crimes. There are separate offences for the failure to disclose money laundering. An overview of these offences is set out below.

The Serious Organised Crime and Police Act (2005) (SOCPA) amends various parts of PoCA. In particular, agents should be aware of the changes to Failure to Disclose offence outlined below.

Primary Offences

There are three primary offences under PoCA and they apply to **<u>all</u>** Lloyd's market participants.

Concealing etc. (s.327)
Where someone knows or suspects that property constitutes someone's benefit from criminal conduct or it represents such a benefit then he commits an offence if he conceals, disguises, converts, transfers or removes that criminal property from England and Wales, Scotland or Northern Ireland.

Arrangements (s.328)
An offence is committed by a person if he enters into or becomes concerned in an arrangement which he knows or suspects facilitates (by whatever means) the acquisition, retention, use or control of criminal property by or on behalf of another person.

Acquisition, use and possession (s.329)
An offence is committed if someone, knowing or suspecting that property constitutes a person's benefit from criminal conduct acquires, uses or has possession of the property.

Reporting suspicious transactions

PoCA imposes disclosure obligations with regard to the primary money laundering offences. The disclosure requirements operate on a two tier basis, with different obligations applying to the "regulated sector" and the "non-regulated sector"

The definition of the regulated sector is complex; however, broadly speaking, the following types of business fall outside the regulated sector:

1) General insurance business; and
2) Long term insurance business which does not relate to qualifying contracts of insurance (as defined in Part 1 of the FSMA 2000 (RAO) 2001).

Therefore, for the most part, business conducted by Lloyd's managing agents falls outside the regulated sector. However, syndicates writing life business and certain other types of long term insurance business (including permanent health insurance) fall within the regulated sector.

The summary of the "failure to disclose" offence for the non-regulated sector is set out below. The "failure to disclose" offences for the regulated sector impose more onerous requirements. If managing agents feel that they fall within the regulated sector they should take appropriate advice. Lloyd's MLRO is happy to provide assistance in this regard.

Failure to disclose – other nominated officers (s.332)

For firms operating outside the regulated sector, a person nominated to receive disclosures under PoCA (usually the MLRO) commits an offence if he:

1) knows or suspects that another person is engaged in money laundering; and

2) he knows the identity of the money launderer **or** the whereabouts of the laundered money **and** he believes that the disclosure identifies the money launderer **or** will assist in identifying the money launderer or the whereabouts of the laundered money; and

3) he does not make the required disclosure as soon as practicable after the information comes to him.

[NB: condition (2) is a new requirement brought in under SOCPA]

Thus, MLROs in the non-regulated sector must assess money laundering reports made to them and if conditions (1) to (3) are satisfied, they must make the appropriate disclosure.

The disclosure requirement is satisfied by making a report to Lloyd's MLRO.

In cases where it is decided not to make a disclosure, a file note should be made outlining the reasons for not doing so. It may be that as time goes by a succession of more minor issues may arise which together give sufficient grounds to make a disclosure.

Please note: The requirement to disclose extends to transactions which have been turned away or not fully completed due to suspicious circumstances.

Tipping Off (ss.333 and 342)

It is an offence for any person if he knows or suspects that a disclosure has been made, to take any action likely to prejudice an investigation by informing or tipping off the person who is the subject of a disclosure (or anyone else involved) that a disclosure has been made or that law enforcement authorities are carrying out or intending to carry out a money laundering investigation.

Where a disclosure has already been made and further enquiries are necessary, great care should be taken to ensure that customers do not become aware that their names have been brought to the attention of the authorities. Lloyd's MLRO is available for consultation where there is uncertainty on how to proceed.

The Information Commissioner has issued guidance which addresses the perceived conflict between the tipping off offence on the one hand, and the individual's right of access to his personal data under the Data Protection Act 1998 and the obligations on financial institutions on the other (see http://www.hm-treasury.gov.uk/media//9A770/money_laundering.pdf for further information).

Obtaining consent to proceed with a transaction (s.336)

If an authorised disclosure is made in relation to a suspicious transaction which has not yet been carried out then consent to proceed with the transaction can be requested from NCIS. Appropriate consent to proceed with a transaction can be provided by Lloyd's MLRO but only where a disclosure has been made by him to NCIS and:

- NCIS' consent has been obtained; *or*
- 7 working days have expired without a response being received from NCIS; *or*
- Consent was refused by NCIS but a 31-day period has expired without notification that law enforcement has taken further action to restrain the transaction.

All MLROs will commit an offence under s.336 if they give consent to an employee to carry out a prohibited act (i.e. a primary offence) if they do not obtain consent from NCIS in accordance with the above requirements.

All disclosures and requests should be made to Lloyd's MLRO for onward transmission to NCIS.

Penalties

The primary offences (sections 327, 328 or 329) carry a maximum penalty of 14 years' imprisonment.

The disclosure and tipping off offences both carry a maximum penalty of 5 years' imprisonments. Failure to disclose may also give rise to the offence of money laundering which carries a maximum penalty of 14 years' imprisonment.

Terrorism Act 2000 (TA)

Section 18 of the TA sets out the 'money laundering' offence, which is defined as:

'entering into or becoming concerned in an arrangement which facilitates the retention or control by or on behalf of another person of terrorist property by concealment, removal from the jurisdiction, transfer to nominees or in any other way'.

This offence is applicable to any person within the UK.

TA also imposes disclosure obligations on a two tier basis, with different obligations applying to the regulated and non regulated sector. The definition of the regulated sector is same as under PoCA and therefore the majority of underwriting agents will fall within the non regulated sector.

Section 19 of TA sets out the disclosure requirements for the non-regulated sector. There is a general duty on a person to report to the firm's MLRO as soon as is reasonably practicable any belief or suspicion that a person has committed an offence under section 18. This duty applies to any person where the information came to his attention in the course of a trade profession, business or employment and is thus applicable to managing agents.

Money Laundering Regulations 2003

The ML Regulations impose obligations to have systems and controls to:

- prevent and detect money laundering;
- have identification procedures for new 'applicants for business';
- maintain record-keeping procedures for identification; and
- have a nominated person to receive disclosures and maintain internal procedures for disclosure.

These obligations apply only in relation to persons who carry on 'relevant business'. Relevant business is defined in the same manner as for PoCA set out above and therefore the majority of managing agents will fall within the non regulated sector.

The ML regulations also impose an obligation to appoint an individual as nominated officer to deal with internal and external reports of suspicious activity.

FSA Money Laundering Sourcebook

The FSA is currently consulting the industry with regard to their proposal to delete the ML Sourcebook. However, the Sourcebook is still in force and its requirements are summarised as follows:

- to have arrangements to enable compliance with its provisions and to appoint a MLRO;
- to take reasonable steps to identify a client by obtaining evidence thereof;
- to take reasonable steps to ensure that a member of staff who has suspicion that a transaction involves money laundering makes a report promptly to the MLRO;
- to provide MLRO with access to 'know your business information';
- to ensure that where appropriate the MLRO reports knowledge or suspicion of money laundering promptly to the NCIS;
- to obtain and make proper use of published government or FATF findings relating to countries outside the UK and to apply those to staff training and 'know your business I information';
- to take reasonable steps to train staff so that they are aware of their responsibilities, the identity of the MLRO, the law relating to money laundering and any breach thereof;
- to regularly assess the firm's compliance with the FSA rules.

Clearly, there is a degree of overlap between the requirements of the ML Sourcebook and the requirements of the ML Regulations. However, the regimes themselves are quite separate: the ML Sourcebook relates to regulatory requirements, whereas the Regulations are concerned with the criminal law. The two regimes are therefore parallel, but complimentary.

The application of the ML Sourcebook to a firm is determined by whether it carries out a 'relevant regulated activity', as defined in the ML Sourcebook. The ML Sourcebook specifically excludes general insurance business and managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's. Thus the majority of managing agents do not fall within the scope of the ML Sourcebook.

2. Developments in Money Laundering Regulation

The National Criminal Intelligence Service ("NCIS") and Financial Action Task Force ("FATF") perceive insurance as a possible weak link in the fight against money laundering. In a 2004 report NCIS indicated that the diverse nature of general insurance exposes the market to numerous threats. The report noted that the focus of the market is mainly on claims fraud and little attention is given to money laundering. In addition, a 2004 FATF report on insurance stated that *"…those parts of the financial system in which anti-money laundering procedures are inconsistently applied are those at most risk of exploitation for money laundering".* The FATF also noted that there is a low detection rate in the insurance industry for money laundering in comparison with the overall size of the industry and has indicated the need to develop insurance industry-specific AML measures, recognising that the nature of money laundering risk is different compared to other financial sectors. It is possible therefore that insurance industry-specific AML procedures will be adopted in the near future, possibly in the next 2-3 years.

At the moment, it is not possible to predict the full extent of these measures but it is likely there will be a requirement for insurers to adopt a risk-based approach to customer due diligence ("CDD") in order to assess the money laundering risk of each business relationship. A risk-based approach starts from the assumption that most customers are not money launderers and recognises that firms should be able to identify where financial crime risks lie in their own businesses. This approach allows firms to focus their efforts where they are most needed and where they will have most impact. Factors to be considered can include issues such as jurisdiction, customer type, class of business etc. Taking a proportionate, risk-based approach to anti-money laundering can have significant benefits to businesses, being cost effective (identifying where limited resources need to be deployed) enabling firms to identify and focus on high risks areas.

It is also noteworthy that the new consultation draft of the Joint Money Laundering Steering Group ("JMLSG") guidance (issued in March 2005 and available from www.jmlsg.org.uk) places responsibility on senior management to ensure that their own firm's procedures are appropriately designed and implemented to reduce the risk of the firm being used to launder criminal proceeds. The draft guidance emphasises the need for senior management to be fully engaged in the decision-making process and take ownership and accountability for the risk-based approach adopted by their firms.

The FSA have taken a similar approach in their consultation paper 05/10 “Reviewing the FSA Handbook” (issued in July 2005 and available from http://www.fsa.gov.uk/pubs/cp/cp05_10.pdf). The FSA propose to delete their Money Laundering Sourcebook and adopt a much less detailed and prescriptive approach. They propose to introduce a limited number of provisions focusing on senior management responsibility and risk management systems and controls. In particular the FSA is keen is keen that firms should be able to streamline their customer identification procedures and adopt a more risk-based approach.

In addition to the developments mentioned above, we would also draw underwriting agents attention to the introduction of the Serious Organised Crime and Police Act (2005) (SOCPA) which amends various parts of PoCA. A useful guide to the changes can be found on the Law Society's website at http://www.lawsociety.org.uk/search/view=query.law# under the heading "Serious Organised Crime And Police Act (2005) Amendments to Part 7 of the Proceeds of Crime Act (2002)". The changes that will be of most interest to underwriting agents relate to the Failure to Disclose offences, an outline of which is included below under the section headed "Legal and regulatory framework".

Finally, we would also refer underwriting agents to the new Financial Action Task Force "Money Laundering and Terrorist Financing Typologies" (issued in June 2005 and available from http://www.fatf-gafi.org) which includes some useful research and analysis on money laundering vulnerabilities in insurance.

3. General Guidance

Money Laundering Reporting Officers (MLROs)

Each underwriting agent must appoint a MLRO to act as the focal point for all activity relating to money laundering. The MLRO is responsible for implementing effective anti-money laundering procedures, monitoring compliance with procedures and reporting annually to the board.

Under FSA rules on approved persons, “money laundering oversight” is a controlled function and MLROs must first obtain FSA approval to act in the role.

It is important that an MLRO has an appropriate level of seniority within the organisation, understands the AML legislation and regulation and has the full support of his firm in carrying out his responsibilities.

Implementing written policies/procedures to combat money laundering

All underwriting agents should adopt written procedures to cover the following:

- Recognition and reporting of suspicious transactions.
- Staff training and awareness; and
- Record keeping.

Written internal policies, procedures and controls should deal effectively with the threat of money laundering and financial crime within each organisation. In order to devise a suitable policy, underwriting agents should identify their own business risks by assessing:

- the risks posed by the products they offer;
- the channels through which business is conducted; and
- the countries in which business is done.

Reporting Requirements

A detailed analysis of underwriting agents’ statutory disclosure obligations is set out under the section headed *Legal and regulatory framework*.

Underwriting agents’ disclosure obligations are satisfied by making a report to Lloyd’s MLRO.

It is essential that each agent has in place procedures to ensure that any suspicion or knowledge of money laundering is reported internally to its MLRO and that this information is passed in turn to Lloyd’s MLRO.

Contact details for Lloyd’s MLRO are as follows:

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Email: mlro@lloyds.com

In his absence, disclosures can be made to:

Andy Wragg
Telephone: 020 7327 6387
Facsimile: 020 7327 5988

Staff training and awareness

Underwriting agents should have an appropriate ongoing training programme to ensure that all relevant staff are aware of the basic requirements of the law and the firm's own internal policies and procedures to identify and deal with suspicious transactions. The purpose of this training should be aimed at improving staff understanding and awareness of money laundering and to emphasise their individual responsibilities of the firm under AML legislation.

All training programmes should be provided as often as necessary to address gaps created by movement of employees within the firm and staff turnover, however, they must be done at least once every 2 years. The method of delivery of training and information is not set and will, therefore, vary depending on the size of the underwriting agent and the nature of its operation.

Underwriting agents should ensure that all training and provision of information to staff is properly documented and records retained.

Record keeping requirements

Transactions must be retained for 5 years from the date on which the transaction was completed or declined. This is an essential component of the audit trail process. If law enforcement agencies investigating a money laundering case cannot link criminal funds passing through the financial systems with the original criminal money, confiscation of the laundered funds cannot be made.

4. Money laundering and insurance: suspicious transactions

We have set out below a list of areas of vulnerability and the factors which may give rise to a suspicion. This list is not exhaustive and some examples may not be appropriate to certain sections or classes of business.

In addition, we have listed some statistics relating to the type of suspicious transactions reported to Lloyd's, which might assist underwriting agents in identifying areas of their business which are vulnerable to money laundering.

In conducting a money laundering risk analysis we would recommend that underwriting agents consider the Money laundering & Terrorist Financing Typologies published by the Financial Action Task Force (FATF). Details of the FATF are included in the final section of this bulletin.

1. New Business

Whilst long-standing customers may be laundering money, it is more likely to be that this kind of activity might be carried out by a new customer using one or more application forms and false names and fictitious companies. The following situations should give rise to suspicions in the new business context:

i. A new corporate/trust client where there are difficulties and delays encountered in obtaining copies of accounts or other documents of incorporation, where required.

ii. The client is reluctant to provide any information or provides information which is difficult for the underwriting agent to verify.

iii. The client uses numerous offshore accounts, companies/structures in circumstances where the client's needs do not support such economic requirements.

iv. A client with no discernible reason for seeking the insurance in question e.g. clients whose requirements are not in the normal pattern of business or the insurance requested.

v. Any transaction involving an undisclosed third party.

vi. The client shows no interest in the performance/general terms of his policy but is more interested in early cancellation of the contract.

vii. Transactions which have no apparent purpose and make no obvious economic sense.

viii. A request to insure goods, assets etc. in transit to or situated in countries where terrorism, the production of drugs, drug trafficking or any organised criminal activity may be prevalent.

2. Payment

Money launderers will often have large amounts of cash that they will try to deposit into the financial system. Therefore, large and unusual payments of premiums should indicate that further due diligence is required. The following situations should give rise to suspicions:

i. The Client purchases policies for an amount which is considered to be beyond his apparent means.

ii. Overpayment of premium with a request to pay the excess to a third party.

iii. Attempts to use a third party cheque when purchasing a policy or payment in cash when the type of business transaction in question would normally be handled by cheques or other methods of payment.

3. Intermediaries/Brokers

There are obviously many legitimate reasons for a client to use an intermediary and for underwriters to deal via intermediaries. However, it should be borne in mind that the use of intermediaries does introduce further parties into the transaction thus increasing opacity, making it easier for a customer to remain anonymous, which is of course a useful tool to the money launderer. It is, therefore, important that underwriting agents conduct thorough due diligence checks on any intermediaries they use. The following situations should give rise to suspicions and may warrant further enquiry:

i. Unnecessarily complex placing chains.

ii. Excessive commission paid to an intermediary who has no apparent involvement in the transaction.

iii. The unnecessary use of an intermediary in a transaction.

iv. The overseas intermediary is based in a jurisdiction which has ineffective or no money laundering legislation, or their rules are not vigorously enforced.[1]

4. Abnormal Transactions

The layering stage of money laundering is critical to the money launderer who wants to introduce numerous layers to a transaction to create opacity and disguise the audit trail. Therefore, money will pass through a number of sources, different persons and entities. The following situations should give rise to suspicions:

i. Assignment of a policy to an apparently unrelated third party.

ii. Early cancellation of policies in circumstances which appear unusual or occur for no apparent reason.

[1] For details on such countries, please refer to the Financial Action Task Force on Money Laundering (FATF) which produces a regularly updated list of Non-Cooperative Countries and Territories (http://www.fatf-gafi.org/NCCT_en.htm)

iii. Cancellation of the policy and a request for the refund to be paid to a third party.

iv. Transactions not in keeping with the normal practice in the class of business to which they relate, e.g. due to nature, size, frequency etc.

v. A number of polices taken out by the same insured for low premiums (normally paid with cash) which are then cancelled with the return of premium made to a third party.

5. Claims

The claims process could be used in the layering and/or integration stage of the money laundering process. It is common practice for small claims to be paid without detailed investigations/enquiries being made by underwriters, thereby giving money launderers the opportunity of moving monies across borders and between entities, again increasing the level of opacity in the transactions. The following situations should give rise to suspicions in this context:

i. Claims requested to be paid to persons other than the insured.

ii. Apparently 'legitimate' claims but they occur with abnormal regularity, e.g. regular small claims within the premium limit.

iii. A change of ownership/assignment of the policy just prior to a loss occurring.

iv. Abnormal loss ratios for the class of risk bound under a binding authority, especially where the coverholder has claims settling authority.

v. Claims investigations sometimes uncover evidence of other suspicious activity independent of the claim. For example, the claims investigator might discover that the claimant enjoys a lifestyle which is beyond his apparent financial means.

6. Suspicious transaction reports from the Lloyd's market - statistics

i. 20% of all referrals relate to concerns over reinsurance coverage - specifically suspicious activity by the reinsured itself, such as premium concerns, doubts over bone fides, handling of claims etc.

ii. 50% of cases related to vault insurance or transit insurance of "exotic" goods – e.g. the storage of cash, precious metals including hafnium, copper, selenium etc – and coverage of gemstones and fine art / paintings. Concerns included:
   - over-inflated value of goods
   - the valuer not being recognised
   - ownership doubts
   - the property in question already having been reported stolen
   - doubts over existence of the property
   - coverage being requested to secure a line of credit.

iii. In one third of referrals the location of the risk (doubts over the country involved) was a factor.

iv. One third of referrals included doubts over the bone fides of the insured.

5. *SOURCES OF INFORMATION ON MONEY LAUNDERING*

Joint Money Laundering Steering Group (JMLSG)
Pinners Hall
105-108 Broad Street
London
EC2N 1EX

Website: http://www.jmlsg.org.uk

The website is a service provided by the British Bankers' Association on behalf of JMLSG and contains important information about countering money laundering.

Financial Action Task Force on Money Laundering (FATF)
FATF/GAFI
2, rue André Pascal
75775 Paris Cedex 16
France

Website: http://www.fatf-gafi.org

The FATF is an inter-governmental body whose purpose is the development and promotion of policies, both at national and international levels, to combat money laundering.

The FATF is also engaged in a major initiative to identify non-cooperative countries and territories (NCCTs) in the fight against money laundering. The current list can be accessed at: http://www.fatf-gafi.org/NCCT_en.htm

The Financial Services Authority (FSA)
25 The North Colonnade
Canary Wharf
London
E14 5HS

Website: http://www.fsa.gov.uk

The International Association of Insurance Supervisors (IAIS)

The IAIS represents insurance supervisory authorities of some 180 jurisdictions and has published some useful guidance on anti-money laundering issues.

Website: http://www.iaisweb.org/

The National Criminal Intelligence Service (NCIS)
PO Box 8000
London
SE11 5EN

Website: http://www.ncis.co.uk

The Economic Crime Branch of NCIS performs the function of receiving and analysing the suspicious transaction reports it receives from the financial sector and disseminates these to law enforcement. This work is vital to the disruption of serious crime.

Her Majesty's Stationery Office (HMSO)

Website: http://www.legislation.hmso.gov.uk

The legislation section of HMSO contains the full text of all Public and Local Acts of the UK Parliament, the Explanatory Notes to Public Acts, Statutory Instruments and Draft Statutory Instruments. Both the full text of the Proceeds of Crime Act 2002 and the Money Laundering Regulations 2003 (statutory instrument) can be found on this site.

HM Treasury

Website: http://www.hm-treasury.gov.uk/documents/financial_services/money/fin_money_index.cfm

This website covers the work on combating money laundering carried out by the HM Treasury's Financial Systems and International Standards Branch.