

Supplement to the Guidance Note on Prevention of Money Laundering

1. Important Note

- 1.1 Unless otherwise indicated, provisions in this Supplement should be read or interpreted in conjunction with the relevant parts of the Guidance Note on Prevention of Money Laundering (“Guidance Note”). (November 2000 version as currently posted in the OCI website – <http://www.info.gov.hk/oci/corner/index.htm> at GN3.)
- 1.2 The Guidance Note and this supplement apply to all authorized insurers, insurance agents and insurance brokers carrying on or advising on long term business (hereinafter referred to as “insurance institutions”) which are not financial institutions authorized by the Hong Kong Monetary Authority under the Banking Ordinance (“authorized financial institutions”). Insurance institutions that are authorized financial institutions are subject to the Guideline on Prevention of Money Laundering issued by the Hong Kong Monetary Authority (“HKMA’s Guideline”). However, to the extent that there are some insurance specific examples of suspicious transactions or money laundering cases in this Guidance Note which may not be shown in the HKMA’s Guideline, the insurance institutions that are authorized financial institutions are required to have regard to Annexes F and G to this Guidance Note in identifying suspicious transactions.

2. Verification of Identity: “Know your customer”

- 2.1 This section supercedes Annex A of the Guidance Note. (Note: paragraphs in italics have already been incorporated in the existing Guidance Note).
- 2.2 *All insurance institutions should institute effective policies and procedures for obtaining identification of new customers.*
- 2.3 *Insurance institutions should not keep anonymous accounts or accounts in obviously fictitious names. They should obtain satisfactory evidence of the identity and legal existence of applicants applying to do business with the insurance institutions, and record that identity and other relevant information regarding the applicant in their files.*
- 2.4 *Where the applicant for business is acting on behalf of another person, appropriate steps should be taken to verify the identity of the applicant*

and the underlying principal.

- 2.5 If claims, commissions, and other monies are to be paid to persons (including companies) other than the policyholders then the proposed recipients of these monies should be the subjects of verification.
- 2.6 Insurance institutions should perform on-going scrutiny of the transactions throughout the course of the business relationship to ensure that the transactions being conducted are consistent with the insurance institution's knowledge of the customer and its business, including, where necessary, identifying the source of funds.
- 2.7 After a business relationship is established, an insurance institution should undertake regular reviews of the existing records on identification information relating to the customer to ensure that they remain up-to-date and relevant. An appropriate time to do so is upon certain trigger events including:
- when a significant transaction is to take place;
 - when there is a material change in the way the account is operated;
 - when the insurance institution is aware that it lacks sufficient information about the customer.
- 2.8 Even when there is no specific trigger event, an insurance institution should consider whether to require additional information in line with current standards from those existing customers that are considered to be of higher risk. In determining the risk profile of a particular customer, the following factors should be taken into account:
- nature of the insurance policy, which is susceptible to money laundering risk, such as single premium policy;
 - customer is connected with certain jurisdictions such as Non-Cooperative Countries and Territories (“NCCTs”) designated by the Financial Action Task Force on Money Laundering (“FATF”) (see paragraphs 2.27-2.33 below), or those known to the insurance institution to lack proper standards in the prevention of money laundering;
 - background or profile of the customer, such as being, or linked to, a politically exposed person (see paragraph 2.10);
 - nature of the customer's business, which may be particularly susceptible to money laundering risk, such as money changers or casinos that handle large amounts of cash;
 - for a corporate customer, unduly complex structure of ownership for no good reason; and
 - any other information that may suggest that the customer is of higher risk (e.g. knowledge that the customer has been refused to enter a relationship by another financial institution).

- 2.9 *Insurance institutions should take particular care in situations where payment is:*
- *offered in cash;*
 - *offered by way of share exchange where it is evident that the shares have been held for less than six months;*
 - *by way of a third party cheque without any apparent connection with the prospective client; and*
 - *by cheque where there is a variation between the policy holder, the signatory and prospective client.*
- 2.10 Insurance institutions should take particular care in situations where a customer whose background or profile is linked to a politically exposed person (see paragraph 7). (This paragraph and paragraph 7 will not take effect until further consideration by the Insurance Authority (“IA”) subsequent to the finalization of the wordings of the revised 40 Recommendations.)

Individual applicants

- 2.11 Identification documents such as current valid passports or identity cards should be obtained. *For Hong Kong residents, the prime source of identification will be the identity cards. File copies of identity documents should be kept.*
- 2.12 *However, it must be appreciated that no form of identification can be fully guaranteed as genuine or representing correct identity. If there is doubt about whether an identification document is genuine, contact should be made with the Immigration Department or the relevant consulates in Hong Kong to ascertain whether the details on the document are correct.*
- 2.13 *In case where suspicion is formed about the identity of the applicant, the name and address should be further checked by using reliable, independent source documents, data or information, e.g. by requesting sight of a recent utility or rates bill or a recent bank statement.*
- 2.14 *It is recommended that the following information of applicants should be recorded:*
- *true name and/or name(s) used (noted with documentary evidence);*
 - *identity card/passport number;*
 - *current permanent address;*
 - *telephone number;*
 - *date of birth;*
 - *nationality¹; and*

¹ For an individual who is a holder of Hong Kong Permanent Identity Card, the verification of nationality is not mandatory.

- *occupation/business.*

Corporate applicants

- 2.15 The following documents or information should be obtained in respect of corporate applicants which are registered in Hong Kong (comparable documents, preferably certified by qualified persons such as lawyers or accountants in the country of registration, should be obtained for those applicants which are not registered in Hong Kong):
- certificate of incorporation and business registration certificate;
 - memorandum and articles of association;
 - a search of the file at Companies Registry.
- 2.16 Where a company is listed in Hong Kong or on a recognized stock exchange (see paragraph 9), the company itself can be regarded as the person whose identity is to be verified. It will therefore generally be sufficient for an insurance institution to obtain the documents specified in paragraph 2.15 above without the need to make further enquiries about the identity of the principal shareholders (control 10% or more of the voting rights of the company), individual directors or authorized signatories. However, evidence that any individual representing the company has the necessary authority to do so should be sought and retained.
- 2.17 Where a listed company is effectively controlled by an individual or a small group of individuals, an insurance institution should consider whether it is necessary to verify the identity of such individual(s).
- 2.18 Where a company acquires an insurance policy with annual premium not exceeding US\$1,000 or with single premium no exceeding US\$2,500; or an insurance policy for pension schemes which does not have surrender clause and the policy cannot be used as collateral, it will generally be sufficient for an insurance institution to obtain the documents specified in paragraph 2.15 above.
- 2.19 Where a financial institution is authorized and supervised by the IA, Hong Kong Monetary Authority (“HKMA”), Securities and Futures Commission or an equivalent authority in a jurisdiction that is a FATF member or that applies standards of prevention of money laundering equivalent to those of the FATF², it will generally be sufficient for an insurance institution to verify that the institution is on the list of authorized (and supervised) financial institutions in the jurisdiction concerned. Evidence that any individual representing the institution has the necessary authority to do so should be sought and retained.

² Equivalent jurisdictions are presently defined as all members of the European Union (including Gibraltar), Netherlands Antilles and Aruba, Isle of Man, Guernsey and Jersey.

- 2.20 In relation to a corporate applicant which does not fall into the descriptions of paragraphs 2.16, 2.18 and 2.19, an insurance institution should look behind the applicant to identify the beneficial owners³ and those who have control over the funds. This means that, in addition to obtaining the documents specified in paragraph 2.15 above, the insurance institution should verify the identity of all the principal shareholders, beneficial owners, at least two directors (including the managing director) and all authorized signatories.
- 2.21 An insurance institution should exercise special care in initiating business transactions with companies that have nominee shareholders. Satisfactory evidence of the identity of beneficial owners of such companies should be obtained.

Unincorporated business

- 2.22 In the case of partnerships and other unincorporated businesses whose partners are not known to the insurance institution, satisfactory evidence should be obtained of the identity of at least two partners and all authorized signatories in line with the requirements for individual applicants. In cases where a formal partnership arrangement exists, a mandate from the partnership authorizing the opening of an account and conferring authority on those who will operate it should be obtained.

Non-face-to-face customers

- 2.23 An insurance institution should whenever possible conduct a face-to-face interview with a new customer to ascertain the latter's identity and background information, as part of the due diligence process.
- 2.24 This is particularly important for high risk customers such as customers requesting to enter into a single premium insurance contract or settle by cash or third party checks. In this case, the insurance institution should ask the customer to make himself available for a face-to-face interview.
- 2.25 Where face-to-face interview is not conducted, for example where the account is opened via the internet, an insurance institution should apply equally effective customer identification procedures and on-going monitoring standards as for face-to-face customers.
- 2.26 An insurance institution should adopt specific and adequate measures to mitigate the risk posed by such non-face-to-face customers. These

³ Beneficial owner is the natural person(s) who ultimately owns or controls a customer (which may include a corporate/partnership customer) and/or the person on whose behalf a transaction is being conducted.

include:

- certification of identity documents presented by suitable certifiers;
- requisition of additional documents to complement those required for face-to-face customers;
- completion of on-line questionnaires for new applications that require a wide range of information capable of independent verification (such as confirmation with a government department);
- independent contact with the customer by the insurance institution;
- requiring the payment for insurance premiums through an account in the customer's name with a bank;
- more frequent update of the information on non-face-to-face customers; or
- in the extreme, refusal of business relationship without face-to-face contact for high risk customers.

Non-Cooperative Countries and Territories

2.27 The FATF has since 2000 engaged in a process of identifying countries and territories which have inadequate rules and practices that impede international cooperation in the fight against money laundering. Such countries/territories are designated as NCCTs.

2.28 The list of NCCTs is published on the FATF website (http://www1.oecd.org/fatf/ncct_en.htm). The FATF reviews periodically the progress of these jurisdictions in addressing the deficiencies identified during the evaluation process.

2.29 An insurance institution should apply Recommendation 21 of the FATF Forty Recommendations to NCCTs. This states that:

“Financial institutions should give special attention to business relations and transactions with persons, including companies and financial institutions, from countries which do not or insufficiently apply these Recommendations. Whenever these transactions have no apparent economic or visible lawful purpose, their background and purpose should, as far as possible, be examined, the findings established in writing, and be available to help supervisors, auditors and law enforcement agencies.”

- 2.30 Extra care should therefore be exercised by an insurance institution in respect of customers (including beneficial owners) from NCCTs. The business rationale for opening an account or applying for insurance services should be clearly ascertained and should be properly documented. In addition, an insurance institution should be fully satisfied with the legitimacy of the source of funds of such customers.
- 2.31 For NCCTs with serious deficiencies and where inadequate progress has been made to improve their position, the FATF may recommend the application of further counter-measures. The specific counter-measures, to be determined by the IA in each case, would be gradual and proportionate to the specific problem of the NCCT concerned. The measures will generally focus on more stringent customer due diligence and enhanced surveillance/reporting of transactions. An insurance institution should apply the counter-measures determined by the IA to such NCCTs.
- 2.32 An insurance institution should be aware of the potential reputation risk of conducting business in NCCTs or other jurisdictions known to apply inferior standards for the prevention of money laundering.
- 2.33 If an insurance institution incorporated in Hong Kong has operating units in such jurisdictions, care should be taken to ensure that effective controls on prevention of money laundering are implemented in these units. In particular, the insurance institution should ensure that the policies and procedures adopted in such overseas units are equivalent to those adopted in Hong Kong. There should also be compliance and internal audit checks by staff from the head office in Hong Kong.

3. Recognition of Suspicious Transactions

- 3.1 This is an area not specifically covered in the Guidance Note. This section should however be read in conjunction with Recognition of suspicious transactions under Annex C of the Guidance Note.

On-going monitoring

- 3.2 In order to satisfy its legal and regulatory obligations, an insurance institution needs to have systems to enable it to identify and report suspicious transactions. However, it is not enough to rely simply on the initiative of front-line staff to make ad hoc reports. An insurance institution should also have management information systems (“MIS”) to provide managers and compliance officers with timely information on a regular basis to enable them to detect patterns of unusual or suspicious activity, particularly in relation to high risk accounts.

- 3.3 This also requires the insurance institution to have a good understanding of what is normal and reasonable activity for particular types of customer, taking into account the nature of the customer's business. Among other things, an insurance institution should take appropriate measures to satisfy itself about the source and legitimacy of funds to be credited to a customer's account. This is particularly the case where large amounts are involved.
- 3.4 MIS reports used for monitoring purposes should be capable of identifying transactions that are unusual either in terms of amount (for example, by reference to predetermined limits for the customer in question or to comparative figures for similar customers) or type of transaction or other relevant risk factors.

4. Reporting of Suspicious Transactions

- 4.1 This section should be read in conjunction with reporting of suspicious transactions under Annex C of the Guidance Note.

Risk management

- 4.2 The senior management of an insurance institution should be fully committed to establishing appropriate policies and procedures for the prevention of money laundering and ensuring their effectiveness. Explicit responsibility should be allocated within an insurance institution for this purpose.
- 4.3 An insurance institution should appoint a compliance officer as a central reference point for reporting suspicious transactions. The role of the compliance officer should not be simply that of a passive recipient of ad hoc reports of suspicious transactions. Rather, the compliance officer should play an active role in the identification and reporting of suspicious transactions. This should involve regular (preferably daily) review by the compliance officer of exception reports of large or irregular transactions generated by the insurance institution's MIS as well as ad hoc reports made by front-line staff.
- 4.4 The compliance officer should form a considered view whether unusual or suspicious transactions should be reported to the JFIU. If a decision is made not to report an apparently suspicious transaction to the JFIU, the reasons for this should be fully documented by the compliance officer. The fact that a report may already have been filed with the JFIU in relation to previous transactions of the customer in question should not necessarily preclude the making of a fresh report if new suspicions are

aroused.

- 4.5 More generally, the compliance officer should have the responsibility for checking on an ongoing basis that the insurance institution has policies and procedures to ensure compliance with legal and regulatory requirements and of testing such compliance.
- 4.6 It follows from this that the insurance institution should ensure that the compliance officer is of sufficient status within the organisation, and has adequate resources, to enable him to perform his functions.
- 4.7 Internal audit also has an important role to play in independently evaluating on a periodic basis an insurance institution's policies and procedures on money laundering. This should include checking the effectiveness of the compliance officer function, the adequacy of MIS reports of large or irregular transactions and the quality of reporting of suspicious transactions. The level of awareness of front line staff of their responsibilities in relation to the prevention of money laundering should also be reviewed. As in the case of the compliance officer, the internal audit function should have sufficient expertise and resources to enable it to carry out its responsibilities.

5. Money Laundering Schemes Uncovered

- 5.1 This section provides supplementary examples in addition to the existing examples in Annex F of the Guidance Note.
- 5.2 A British insurance sales agent was convicted of violating a criminal money-laundering statute. The insurance agent was involved in a money-laundering scheme in which over \$1.5 million was initially placed with a bank in England. The "layering process" involved the purchase of single premium insurance policies. The insurance agent became a top producer at his insurance company and later won a company award for his sales efforts. This particular case involved the efforts of more than just a sales agent. The insurance agent's supervisor was also charged with violating the money-laundering statute. This case has shown how money laundering has reached into the insurance industry and if coupled with a corrupt employee can expose an insurance company to negative publicity and possible criminal liability.

6. Examples of Suspicious Indicators

6.1 This section provides supplementary examples in addition to the existing examples in Annex G of the Guidance Note.

General examples

6.2 A customer applies for an insurance policy relating to business outside the customer's normal pattern of business.

6.3 A customer requests for a purchase of policy in amount considered beyond his apparent need.

6.4 A customer attempts to use cash to complete a proposed transaction when this type of business transaction would normally be handled by cheques or other payment instruments.

6.5 A customer refuses, or is unwilling, to provide explanation of financial activity, or provides explanation assessed to be untrue.

6.6 A customer is reluctant to provide normal information when applying for a policy, providing minimal or fictitious information or, provides information that is difficult or expensive for the institution to verify.

6.7 Delay in the provision of information to enable verification to be completed.

6.8 Opening accounts when the customer's address is outside the local service area.

6.9 Opening accounts with names very close to other established business entities.

6.10 Attempting to open or operating accounts under a false name.

6.11 Any transaction involving an undisclosed party.

6.12 A transfer of the benefit of a product to an apparently unrelated third party.

6.13 Activity is incommensurate with that expected from the customer considering the information already known about the customer and the customer's previous financial activity. (For individual customers, consider customer's age, occupation, residential address, general appearance, type and level of previous financial activity. For corporate customers, consider type and level of activity.)

- 6.14 Any unusual employment of an intermediary in the course of some usual transaction or formal activity e.g. payment of claims or high commission to an unusual intermediary.
- 6.15 A customer appears to have policies with several institutions.
- 6.16 A customer wants to borrow the maximum cash value of a single premium policy, soon after paying for the policy.
- 6.17 The customer who is based in NCCTs designated by the FATF from time to time or in countries where the production of drugs or drug trafficking may be prevalent.
- 6.18 The customer who is introduced by an overseas agent, affliator or other company that is based in NCCTs designated by the FATF from time to time or in countries where the production of drugs or drug trafficking may be prevalent.

Specific examples

Single premium

- 6.19 An example involves the purchase of large, single-premium insurance policies and their subsequent rapid redemption. A money launderer does this to obtain payment from an insurance company. The person may face a redemption fee or cost, but this is willingly paid in exchange for the value that having funds with an insurance company as the immediate source provider.
- 6.20 In addition, the request for early encashment of single premium policies, for cash or settlement to an individual third party may arouse suspicion.

Over payment of premiums

- 6.21 Another simple method by which funds can be laundered is by arranging for excessive numbers or excessively high value of insurance cheques or wire transfers to be made.
- 6.22 A money launderer may well own legitimate assets or businesses as well as the illegal enterprise. In this method, the launderer may arrange for insurance of the legitimate assets and ‘accidentally’, but on a recurring basis, significantly overpay his premiums and request a refund for the excess. Often, the person does so in the belief that his relationship with his representative at the company is such that the representative will be unwilling to confront a customer who is both profitable to the company

and important to his own success.

Assignment of claims

- 6.23 In a similar way, a money launderer may arrange with groups of otherwise legitimate people, perhaps owners of businesses, to assign any legitimate claims on their policies to be paid to the money launderer.
- 6.24 The launderer promises to pay these businesses, perhaps in cash, money orders or travelers cheques, a percentage of any claim payments paid to him above and beyond the face value of the claim payments.
- 6.25 In this case the money laundering strategy involves no traditional fraud against the insurer. Rather, the launderer has an interest in obtaining funds with a direct source from an insurance company, and is willing to pay others for this privilege.
- 6.26 The launderer may even be strict in insisting that the person does not receive any fraudulent claims payments, because the person does not want to invite unwanted attention.

Return premiums

- 6.27 There are several cases where the early cancellation of policies with return of premium has been used to launder money. This has occurred where there have been:
- a number of policies entered into by the same insurer/intermediary for small amounts and then cancelled at the same time;
 - return premium being credited to an account different from the original account;
 - requests for return premiums in currencies different to the original premium; and
 - regular purchase and cancellation of policies.

7. Politically Exposed Persons

(This paragraph and paragraph 2.10 will not take effect until further consideration by the IA subsequent to the finalization of the wordings of the revised 40 Recommendations.)

- 7.1 This is a new section not currently covered in the Guidance Note.
- 7.2 Business relationships with individuals holding important public positions as well as persons or companies clearly related to them (i.e. families, close associates etc) expose an insurance institution to particularly significant reputation or legal risks. There should be enhanced due diligence in

respect of such politically exposed persons (“PEPs”).

- 7.3 PEPs are defined as individuals being, or who have been, entrusted with prominent public functions, such as heads of state or of government, senior politicians, senior government, judicial or military officials, senior executives of public organizations and important political party officials. The concern is that there is a possibility, especially in countries where corruption is widespread, that such PEPs may abuse their public powers for their own illicit enrichment through the receipt of bribes etc.
- 7.4 An insurance institution should gather sufficient information from a new customer, and check publicly available information to establish whether or not the customer is a PEP. An insurance institution considering to establish a relationship with a person suspected to be a PEP should identify that person fully, as well as people and companies that are clearly related to him.
- 7.5 An insurance institution should also ascertain the source of funds before accepting a PEP as customer. The decision to open an account for a PEP should be taken at a senior management level.
- 7.6 Risk factors an insurance institution should consider in handling a business relationship (or potential relationship) with a PEP include:
- any particular concern over the country where the PEP is from, taking into account his position;
 - any unexplained sources of wealth or income (i.e. value of assets owned not in line with the PEP’s income level);
 - expected receipts of large sums from governmental bodies or state-owned entities;
 - source of wealth described as commission earned on government contracts;
 - request by the PEP to associate any form of secrecy with a transaction; and
 - use of accounts at a government-owned bank or of government accounts as the source of funds in a transaction.

8. Other requirements

- 8.1 These are new requirements not currently covered in the Guidance Note.
- 8.2 Where the local law of the overseas branches or subsidiaries of the insurance institution and this Guidance Note are in conflict, the overseas branch or subsidiary should comply with their local law and inform immediately the Commissioner of Insurance through their Head Office of such conflict.
- 8.3 Insurers should foster close working relationships between underwriters and claims investigators.
- 8.4 Where the minimum anti-money laundering requirements of the home and host jurisdictions differ, branches and subsidiaries in host jurisdictions should be required to apply the higher standard.

9. Recognized stock exchange (i.e. Stock market of a country which is a member of FATF and the stock market is recognised by the Securities and Futures Commission for the purposes of section 65A(2)(a) of the Securities Ordinance)

- Auckland Stock Exchange
- American Stock Exchange
- Amsterdam Stock Exchange
- Australian Stock Exchange Limited
- Brussels Stock Exchange
- Copenhagen Stock Exchange
- Frankfurt Stock Exchange
- Luxembourg Stock Exchange
- Milan Stock Exchange
- Montreal Stock Exchange
- National Association of Securities Dealers (USA)
- New York Stock Exchange
- Osaka Stock Exchange
- Oslo Stock Exchange
- Paris Bourse
- Singapore Stock Exchange
- Stockholm Stock Exchange
- The International Stock Exchange of the United Kingdom and the Republic of Ireland Limited
- Toronto Stock Exchange
- Tokyo Stock Exchange
- Wellington Stock Exchange
- Zurich Stock Exchange