

ICP 22 - Identifying, understanding & assessing ML/TF risks within the insurance sector

Bermuda case study

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The view expressed in this presentation do not necessarily reflect the views of the Bermuda Monetary Authority, its Management or Directors.

Overview of Presentation

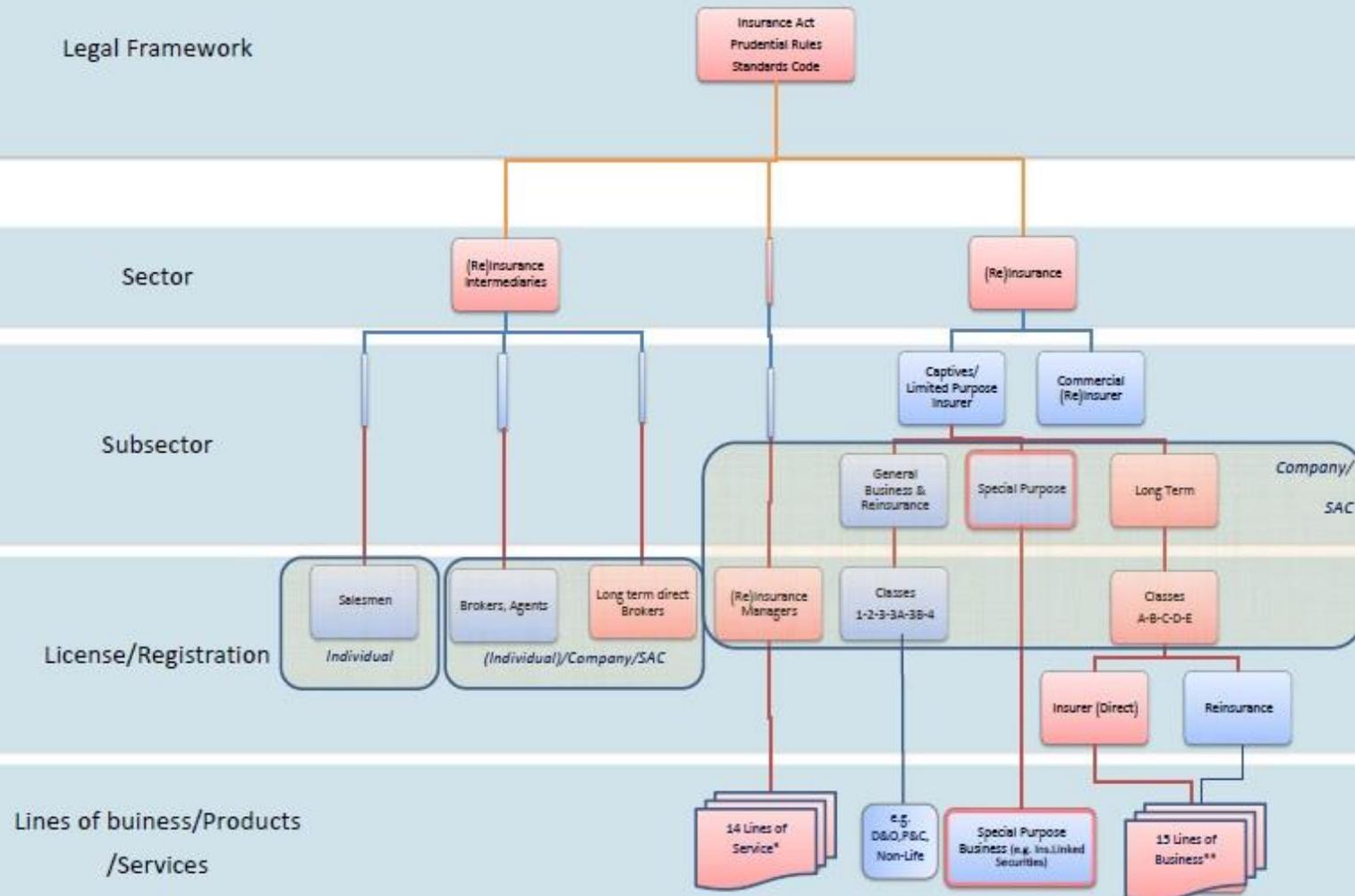
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Introduction – Overview of Bermuda Financial Sector

- Bermuda's financial sector can be broken down into domestic sector & the international sector;
- The size and relevance of the international sector makes Bermuda an International Financial Centre (IFC);
- Bermuda hosts the third largest reinsurance market in the world;
- Bermuda is predominantly an insurance-based IFC, specializing in the niche of catastrophe reinsurance;

<u>Bermuda Financial Sector</u>				
Dec-16	<i>Insurance</i>	<i>Banking</i>	<i>Investment Funds</i>	<i>Total</i>
<i>US\$ bln</i>	631.71 (80%)	22.71 (3%)	137.15 (17%)	791.57
<i># of entity</i>	1,224	4	567	1,795

Introduction – Overview of Bermuda's Insurance Sector



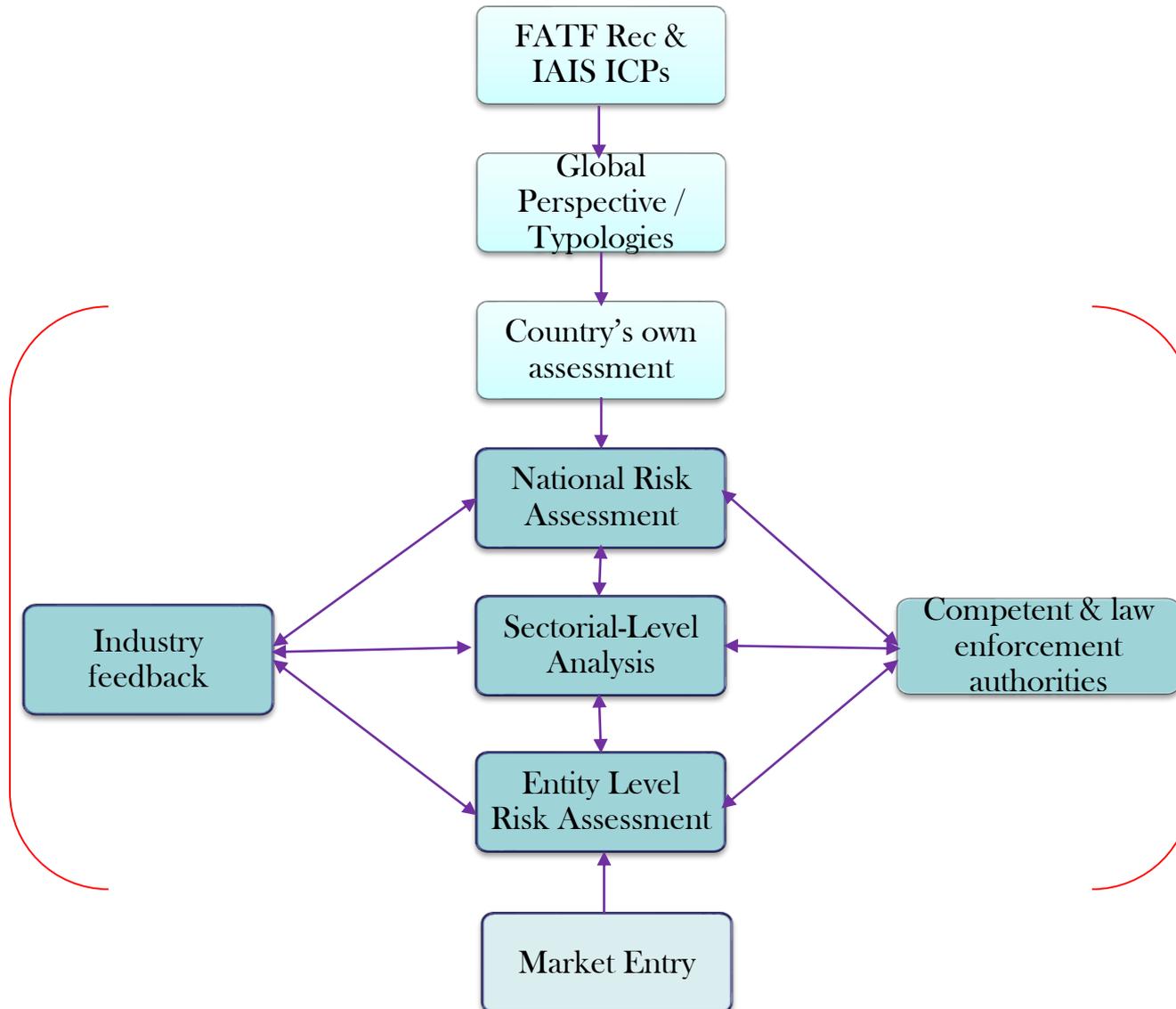
Overview of FATF Recommendations

- In 2012, the FATF revised its Recommendations
- The revised Recommendations put much emphasis on the Risk-based Approach (RBA)
- Specifically, Recommendation 1 requires countries to identify, assess, and understand their ML/TF risk and subsequently apply a RBA
 - ❖ RBA takes a more focused approach on high ML/TF risk areas, allowing countries to:
 - i. adopt measures commensurate with the risk identified; and*
 - i. Ensure resources are allocated in the most effective way.*

Overview of ICP 22

- ICP 22 was revised in 2013 to align the standard to the FATF requirements;
- Applied at a minimum to the supervision of life insurance and investment-related insurance;
- Supervisors are required to consider if the standard should apply to the non-life sector;
- The focus should be on the activity, not the names attached to the institutions;

Identifying & Understanding ML/TF Risk – BMA Approach



Market Entry (Licensing and Authorization)

- **Is the first line of defense**

- i.e. prevent criminals from owning/controlling financial institutions (e.g. insurance entity)

- **BMA's approach to licensing:**

- All insurance entities must have a license to conduct business in Bermuda

- Process for licensing include:

- Conducting fit and proper test (including background checks) on all beneficiary owners and or controllers;
- Assessing the insurer's business plan and governance arrangements;
- Assessing the insurer's AML/CFT policies and procedures; and
- Vetting and approval of the insurer's application by the Assessment and Licensing Committee (ALC)

Assessing ML/TF risk – BMA Approach

- BMA developed its own internal ML/TF Risk Assessment Model
 - The Model is an analytical tool that provides a formal and systematic process for assessing the level of ML/TF risk, in a consistent way, across all the entities regulated by the BMA.
- The Model calculates ML/TF risk for each entity (Entity Risk Score) using an internally developed formula i.e.

$$\text{ERS} = (\text{Inherent Risk} - \text{Quality of Mitigants}) \times \text{Exposure Level} \\ \times \text{Sectoral Charge} \pm \text{Other Variables} \pm \text{AML Adjustment}$$

Whereby:

Inherent Risk - Quality of Mitigants = Residual Risk

Assessing ML/TF risk – cont.

ERS = (Inherent Risk – Quality of Mitigants) x Exposure Level x Sectoral Charge +/- Other Variables +/- AML Adjustment

Inherent Risk = Customer Risk + Product and Service Risk + Geographic Exposure Risk + Channels of Distribution Risk

- ***Customer Risk*** – Insurer’s own client risk rating
- ***Product and Services Risk*** – Insurer’s license class & lines of business e.g. whole life, term life annuities etc.
- ***Geographic Exposure Risk*** – country of residence of insurer’s policy holder; country of residence of insurer’s primary beneficiaries; the country of resident of the PEPs included in the insurer’s client base
- ***Channels of Distribution Risk*** – The means used by insurer to conduct business with its client; the means used by the insurer to communicate with its client

Assessing ML/TF risk – cont.

ERS = (Inherent Risk – Quality of Mitigants) x Exposure Level x Sectoral Charge +/- Other Variables +/- AML Adjustment

Quality of Mitigants = Internal Controls + Corporate Governance + Employee's Integrity & Knowledge + Licensee/Entity Data

- ***Internal Controls*** - e.g. AML/CFT policies and procedures and frequency of internal review; registered with GOAML;
- ***Corporate Governance*** - e.g. composition of the board of directors & its role;
- ***Employee integrity & Knowledge*** - e.g. vetting of new employees and AML/ATF trainings provided to employees;
- ***Licensee/Entity Data*** - e.g. listed on a stock exchange; number of SARs filed.

Assessing ML/TF risk – cont.

ERS = (Inherent Risk – Quality of Mitigants) x Exposure Level x Sectoral Charge +/- Other Variables +/- AML Adjustment

- ***Exposure Level*** = impact, expressed in terms of the entity's size i.e. GWP; Claims paid; number of policyholders/beneficiary owners; balance sheet size of the insurer;
- ***Sectoral Charge*** = National Risk Assessment sectoral risk rating;
- ***Other Variables*** = Onsite/Offsite results (AML & Prudential) +/- Intelligence from other relevant agencies e.g. FIA +/- AML/CFT independent audit report;
- ***AML Adjustment*** = A manual adjustment to take into account any other factors or information not reflected in the model e.g. pending enforcement action;

Assessing ML/TF risk – cont.

Model Structure

	<u>Insurer</u>	<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>
Inherent Risk					
Customer		X	X	X	X
Product & Services		X	X	X	X
Geographic exposure		X	X	X	X
Channels of distribution		X	X	X	X
Inherent Risk Score		XX	X	XX	X
Less					
Quality of Mitigates					
Internal Controls		X	X	X	X
Corporate Governance		X	X	X	X
Employee Integrity					
Licensee/Entity Data		X	X	X	X
Quality of Mitigates Score		X	X	X	X
Residual Risk (i-qm)		XX	X	XX	X
Multiply					
Exposure Level (Impact)					
e.g. size of entity		X	X	X	X
		XX	XX	XX	XX
Multiply					
Sectoral charge (NRA)		X	X	X	X
Level 1 Adjusted Results		XX	XX	XX	XX

Assessing ML/TF risk – cont.

Model Structure

Add/less	Level 1 Adjusted Results	XX	XX	XX	XX
	Other Variables				
	Independent audit report	X	X	X	X
	AML Onsite/Offsite review	X	X	X	X
	Prudential onsite review	X	X	X	X
	Level 2 Adjusted Results	XX	XX	XX	XX
Add/less	AML Adjustment (Model Challenge)	X		X	
	Entity Risk Profile/Score	XX	XX	XX	XX
	Risk Rating	HIGH	MEDIUM	MEDIUM	LOW

Monitoring ML/TF Risk

- **Onsite Reviews;**
 - Results from the assessment serve as the primary input in determining the onsite program (including the frequency and intensity);
 - Priority is given to the areas of higher risk, either at the level of an individual entity or a particular sector.
- **Offsite Monitoring** - conducted through out the year; uses AML statutory filings; Assessment results; Independent audit reports; prudential data/results;
- **Thematic Reviews** - used to assess a specific risk across the entire sector;
- **Outreach (to industry)** - Quarterly bilateral meetings with the industry representative; ongoing workshops to share information e.g. NRA results; providing sectoral guidance notes;
- **Outreach (to other competent and law enforcement authorities)** - Supervisor Review Committees; Operational Working Groups; regular meeting with FIU

Remediation and Enforcement

➤ Effective remediation and enforcement actions should be:

- proportionate to the severity of the deficiency identified;
- effective to discourage non-compliance in the future;
- Capable of fostering an effective risk management culture within the industry;
- Transparent and fair;

➤ BMA's remediation and enforcement tools include:

- | | |
|--|--|
| ❖ Bringing the failure to the attention of the entity concerned; | ❖ Public censure |
| ❖ Sending a warning Notice; | ❖ Objections to controllers |
| ❖ Imposition of directions, restrictions and conditions ; | ❖ Prohibition orders against individual directors and officers |
| ❖ Imposition of a civil penalty | ❖ Revocation of license |
| ❖ Injunctions | ❖ Winding up |
| | ❖ Referral to the Police |

➤ The BMA endeavor to publish all its enforcement actions to inform the public, maximize the deterrent effect of enforcement actions and to ensure the transparency

On-going review of the supervisory framework

- **For effectiveness:**
 - Assess for changes/improvements on follow-up onsite/offsite reviews;
 - Review subsequent NRAs for improvements on sectoral level residual risk;
 - Review trends in SARs

- **For emerging/new risk:**
 - Assess new players on the market;
 - Assess new products on the market;
 - Review NRAs for new ML/TF risks including new trends;
 - Review trends in SARs

The above process should trigger the re-identification and reassessment of risk process

Closing Remarks

- FATF Rec and ICP 22 apply at a minimum to life insurance - therefore, the onus is on the country to justify, with empirical evidence, why other segment of the insurance sector should be exempted;
- The FATF Rec and IAIS ICPs are not crystal balls - there is need to use judgment to align and tailor the standards to your jurisdiction;
- The involvement of the private sector and other competent and law enforcement authorities, including sharing of information, is valuable in building a complete picture of your ML/TF risks;
- Understanding, Identifying & Assessing ML/TF risks is not a one off event - the process should be undertaken on a regular basis;
- ML/TF risks should not be looked at in isolation of other entity risks such as prudential, governance and market conduct;

Q & A

Q