## Opinion of the European Banking Authority on the risks of money laundering and terrorist financing affecting the European Union's financial sector

***This paper summarises the main findings and the proposed actions related to Life Insurance Undertakings (LIUs) and our point of view on the key considerations and practical steps LIUs should take to proactively address the findings in the joint opinion and pre-empt CA concerns.***

### Executive Summary

Article 6(5) of the EU's Fourth Money Laundering Directive (2015/849) (4MLD) requires the European Supervisory Authorities (ESAs) to issue their joint opinion on the risks of money laundering and terrorist financing (ML/TF) affecting the European Union's (EU's) financial sector every two years.

On 3 March 2021, the European Banking Authority (EBA) issued the 3rd Joint Opinion. The EBA issued the joint opinion as part of its new mandate to lead, coordinate and monitor the fight against ML/TF in the financial system at the EU level. The European Securities and Markets Authority (ESMA) and European Insurance and Occupational Pensions Authority (EIOPA) were closely involved in the process.

The survey was informed by over 50 Competent Authorities (CAs) responsible for the AML/CFT supervision of credit and financial institutions. The joint opinion sets out proposed actions addressed to CAs, which are based on the detailed analysis and findings set out in the report. The key findings and proposed actions include:

- CAs considered the sector of life insurance undertakings as presenting moderately significant or less significant risk from an inherent ML/TF risk perspective.
- Using intermediaries and agents is more prevalent in insurance than other sectors and as such constitutes an increasing risk factor for LIU's.
- Main customer risks include, PEP's, payments to customer's accounts abroad, fraud, use of cash, ongoing relationship with a customer other than a natural person or a beneficiary other than the customer.
- The increased use of FinTech and RegTech solutions in the sector appears to be a key emerging risk.
- A large proportion of CAs indicated they had not assessed the quality of controls put in place in the sector, and those that had done so have assessed the controls put in place by firms in the sector as good overall.
- CA's were more concerned about the effectiveness of controls, in particular controls related to ongoing monitoring of transactions and STR reporting, as well as the quality of business-wide and customer risk assessments.

- The type of breaches that were identified by CAs as a result of their supervisory activities were mainly linked to internal controls and overall AML/CFT policies and procedures, customers' and business-wide risk assessments, and customers' identification and verification.

To mitigate supervisory concerns and demonstrate robust systems and controls, Plenitude recommend the following actions should be proactively undertaken by LIU's

- Ensure that AML/CFT policies and procedures fully reflect applicable laws, regulations and guidance.
- Conduct a formal review and gap analysis of the current AML/CFT risk assessment and Customer Risk Rating Methodology to ensure they fully meet regulatory requirements.
- Conduct and evidence a review of the existing monitoring and controls testing plan to ensure testing is appropriate, meets regulatory expectations and provides appropriate coverage across all intermediaries, agents, outsourced arrangements and AML/CFT controls.
- Ensure that the controls related to ongoing monitoring of transactions are effective and calibrate and test any transaction monitoring systems on an ongoing basis so that they remain aligned to AML/CFT risk assessments and regulatory requirements.
- To mitigate the risk of the increased use of FinTech and RegTech solutions, LIUs must seamlessly align and integrate all associated business processes, data systems, and technical architectures; and evidence they understand the configuration and operation of the solutions.
- Consider broader training and awareness initiatives to improve the quality of controls, reinforce roles and responsibilities across the Three Lines of Defence model and drive the required 'culture of compliance'.
- Review and enhance the current Management Information reporting suite in terms of existing Key Performance Indicators (KPI's) and Key Risk Indicators (KRIs) related to quality of controls.

## 1. Life Insurance Undertakings

The following text from the joint opinion identifies the key risks and proposals for the LIU sector:

- *"The EBA notes that CAs considered the sector of life insurance undertakings as presenting moderately significant or less significant risk from an inherent ML/TF risk perspective. A small proportion of CAs however indicated that the sector presented significant risks.* ***The EBA observes that a large proportion of CAs indicated they had not assessed the quality of controls put in place in the sector, and those that had done so have assessed the controls put in place by firms in the sector as good overall.*** *The EBA underlines that the sector has received a relatively low level of supervisory activity which is in line with the risk-based approach and the sector is mostly supervised through AML/CFT returns."*

In the light of those findings, the EBA suggested that the following steps should be taken by CAs with responsibility for supervising LIUs:

- *"the EBA proposes* ***that CAs obtain sufficient information on the quality of controls to ensure a comprehensive understanding of the sector****.*
- *"In line with the risk-based approach****, EBA furthermore encourages CAs to find the most effective supervisory tools to supervise this sector.*** *The sector is diverse and not all life insurance products are low risk."*
- *"proposes that CAs identify and assess emerging risks in the sector…****the EBA recommends that CAs train themselves to understand risks associated with RegTech solutions****".*

## 2. Quality of Controls

At least 25 of the 50 CAs indicated that **the data they provided for their assessment of the quality of controls put in place by firms was based on a formal risk assessment**, such as the one envisaged in the risk-based supervision guidelines. Furthermore**, a large proportion of CAs (c.15) have not assessed the quality of controls in this sector.**

- *"Overall, most CA's that assessed the controls put in place by firms in the sector rated them as good. This result is similar to Joint Opinion 2019, and CA's appeared to be relatively satisfied with the adequacy of controls related to the policies and procedures, particularly identification and verification of customers and record-keeping.* ***However, they were more concerned about the effectiveness of some of these controls, in particular controls related to ongoing monitoring of transactions and STR reporting, as well as the quality of business-wide and customer risk assessments."***
- *"This could be explained by the fact that typically* ***LIUs receive less information from the customer after the start of the relationship because of the low frequency and or variability of the transactions afterwards compared to, for example, the banking sector.*** *This however may be mitigated by the fact that the transactions are mostly provided through bank accounts, which are generally covered by effective controls"*
- ***"A significant proportion of CAs that has increased since the Joint Opinion 2019 indicated that the sector's awareness of ML/TF risks was still of concern****. This may affect the overall effectiveness of the controls in place."*

## 3. Breaches Identified

As a result of the supervisory activities related to LIUs, CAs identified minor or moderate breaches**. While the number of breaches had increased from 2018 to 2019, this may be attributed to more intensive supervisory activities performed by two CAs and did not necessarily point to an overall upward trend.**

- *"In 2018 and 2019, the type of breaches that were identified by CAs as a result of their supervisory activities* ***were mainly linked to internal controls and overall AML/CFT policies and procedures, customers' and business-wide risk assessments, and customers' identification and verification.*** *Breaches found in the sector are therefore not entirely in line with the assessment of the quality of controls. This may be attributed to the fact that internal controls and customer due diligence is the key element of most supervisory actions in the sector and that AML/CFT supervisory procedures may focus on CDD measures. On the other hand, record-keeping is being assessed as one of the least identified breaches, across both years under review."*

Feedback from CAs suggested that **the most common follow-up measures were orders to implement measures, or orders to comply, or orders to put in place a remediation plan, which reflects breaches** being considered minor or moderate.

## 4. Inherent Risk

Overall, the majority of CAs considered that the LIU sector posed a moderately significant or less significant inherent ML/TF risk to the EU's financial sector.

- *"Compared to the previous joint opinion* ***delivery channels are considered to present an increased level of risk.****"*
- ***"Using intermediaries and agents is more prevalent in insurance than other sectors and as such constitutes an increasing risk factor****…for LIU's."*
- *"main customer risks cited…****PEP's, payments to customer's accounts abroad, fraud, use of cash, ongoing relationship with a customer other than a natural person or a beneficiary other than the customer.*** *However, these customers' risks were still considered as presenting moderately or less significant risks."*

## 5. Overall Risk Profile and Emerging Risks

As in the 2nd joint opinion (2019), after considering inherent risks and controls, a significant proportion of the CAs view the overall ML/TF risk profile of the LIU sector as moderately significant or less significant. Very few CAs considered that the sector presented significant risk.

- *"…after considering inherent risks and controls, a significant part of CA's view the overall ML/TF risk profile in the sector as moderately significant or less significant…the overall risk factor of this sector has therefore been stable since the (2019) joint opinion, with the exception of inherent risks that have moved towards the moderate level**. This may be linked to the spread of new technologies and web-based platforms…the increased use of FinTech and RegTech solutions in the sector appears to be a key emerging risk**."*

## 6. Key Considerations for LIUs

Our view is that the joint opinion clearly signals that CA's should apply a greater focus on the quality of controls in LIUs as part of their supervisory approach, including the review of AML/CFT returns and inspections. Separately the breach findings provide thematic considerations with respect to internal controls, AML/CFT policies and procedures, customer and business-wide risk assessments.

Based on Plenitude's extensive work across the Life Insurance sector and interaction with regulators, the following actions should be proactively undertaken by LIUs to mitigate supervisory concerns and demonstrate robust systems and controls:

- **Ensure and evidence that AML/CFT policies and procedures fully reflect applicable laws, regulations and guidance** by conducting a formal gap analysis against a comprehensive Obligations Register, such as Plenitude RegSight;

- **Conduct and evidence a formal annual review and gap analysis of the current AML/CFT risk assessment**, in particular ensure that the methodology meets regulatory requirements with respect to risk factors (Customer, Products and Services, Jurisdiction, Transactions, and Delivery channels); and consider control effectiveness and quality. As required, the approach and methodology should be enhanced and executed across all AML/CFT controls and Obliged Entities;

- **Conduct and evidence a formal review and gap analysis of the Customer Risk Rating methodology** to ensure it meets regulatory requirements, in particular ensure the methodology reflects all risk factors i.e. Customer Characteristics, Countries/Locations, Products, Distribution Channels and Transactions/Operations; and has an appropriate weightings applied to determine the overall risk score. Supporting risk lists should also be reviewed on a regular basis to ensure they meet regulatory requirements and evolving risk indicators;

- To mitigate the risk associated with perceived vulnerabilities in relation to delivery channels stemming from the use of intermediaries and agents**, conduct and evidence a review of the existing monitoring and controls testing plan to ensure that it provides appropriate coverage across all intermediaries, agents, outsourced arrangements and AML/CFT controls**, and determine whether current testing is appropriate and meets regulatory expectations;

- For ongoing monitoring of transactions, **ensure that the controls related to ongoing monitoring of transactions are effective by amongst other things: including mechanisms to identify and implement relevant life insurance risk typologies into the ongoing monitoring of transaction, using sources such as the latest EBA Guidelines on ML and TF risk factors** and calibrate and test any transaction monitoring systems on an ongoing basis so that they remains aligned to AML/CFT risk assessments and regulatory requirements;

- To mitigate the risk of the increased use of FinTech and RegTech solutions, **LIUs must seamlessly align and integrate all associated business processes, data systems, and technical architectures. There should be a documented methodology (where appropriate) to ensure LIU's can evidence they understand the**

**configuration and operation of the solution,** with regular reviews to ensure alignment with evolving regulatory requirements;

- For STR reporting, consider the requirement to file a report with the domestic FIU in relation to funds that are related to the proceeds from criminal activity or terrorism. **Putting in place a STR training regime helps to raise awareness for staff reporting suspicion and ensures LIUs have the ability, competence and resources to identify and report suspicious activity promptly;**

- **Review the current Management Information reporting suite in terms of existing Key Performance Indicators (KPI's) and Key Risk Indicators (KRIs).** Candidate metrics relating to quality of controls include: QC pass rates for CDD and EDD, Transaction Monitoring (TM) alert volumes and ageing, QC pass rates for TM, STR filings, including first line defence escalations to the AML Office. These should also be considered for Risk Appetite metrics and be presented on a regular basis to appropriate governance forums and senior management, and;

- **Consider broader training and awareness activity with 1st and 2nd Line staff across all financial crime controls to raise awareness of ML/TF risks** using specific Life Insurance examples, reinforce roles and responsibilities across the Three Lines of Defence to drive the required 'culture of compliance' and more effective risk management.

## AUTHORS

**Alan Paterson**
**Managing Director**
**E-mail: alan.paterson@plenitudeconsulting.com**
**Tel: +44 (0)203 102 956**
**Mobile: +44 (0)7968 038 369**

**Joby Carpenter**
**Senior Manager**
**E-mail: joby.carpenter@plenitudeconsulting.com**
**Tel: +44 (0)203 102 956**
**Mobile: +44 (0)7813 603 555**

## ABOUT PLENITUDE

Plenitude are Financial Crime, Risk and Compliance specialists, offering advisory, transformation services and innovative cloud-based RegTech subscription products. We help our clients meet their regulatory obligations and reduce their financial crime risk exposure by providing deep subject matter expertise, advisory and transformation services. Our RegTech subscription products which are used by leading financial institutions, offer clients enhanced insight into the vast array of FCC laws, regulations, guidance and risk indicators globally.

Plenitude has extensive experience of assisting Life Insurers with assessing and improving their financial crime controls and have a proven suite of assets and deliverables developed specifically for the Life Insurance industry that can be rapidly deployed and customised for client's needs. This includes a multi jurisdiction FCC Obligations Register (RegSight), benchmark Policies and Procedures, Customer Risk Rating methodologies, Financial Crime Risk Assessments and Monitoring and Controls Testing Plans covering all AML/C controls, which fully reflect the requirements of the 4th/5th Money Laundering Directives and ESA Risk Factor Guidelines.

Our consultants come from a variety of backgrounds and disciplines across consulting, in-house financial crime compliance, regulators, government and law enforcement. As experts in financial crime compliance, we fully understand the financial crime compliance challenge, and have the expertise and skills to design and implement effective programmes or initiatives.

To find out more go to: www.plenitudeconsulting.com