SOUTH AFRICAN RESERVE BANK
Prudential Authority

Risk assessment of money laundering and terrorist financing in the life insurance sector

July 2022

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1. Executive summary

This is the second life insurance sector risk assessment conducted by the Prudential Authority (PA). The first assessment was conducted in 2019, and the executive summary thereof is available on the South African Reserve Bank (SARB) website.[1] The purpose of this assessment is to help the PA to better understand the money laundering (ML), terrorist financing (TF) and proliferation financing (PF) risks within the life insurance sector. A decision was taken to focus on the primary life insurers and life cell captives (cell captives). Reinsurers were excluded from the scope of this assessment. Schedule 1 of the Financial Intelligence Centre Act 38 of 2001, as amended (FIC Act), includes life insurers but excludes the non-life insurance sector.

The assessment was conducted in line with Recommendation 1 of the Financial Action Task Force (FATF) Recommendations, which requires that countries identify, assess and understand the ML/TF risks within their respective jurisdictions and take appropriate action, including designating an authority and/or a mechanism to coordinate actions to assess these risks and apply resources aimed at ensuring that such risks are mitigated effectively. Recommendation 1 also states that countries should identify, assess and understand the PF risks for the country.

In conducting this assessment, survey-type questionnaires were distributed to life insurance businesses and information was requested from the Financial Intelligence Centre (FIC), law enforcement agencies and the Insurance Crime Bureau. The data was analysed and interpreted to understand potential sectoral risk levels of ML/TF/PF.

2. Purpose

This sector risk assessment conducted during the two-year period, 2021 and 2022, aims to assist the life insurers that fall within the purview of the PA's supervision to become aware of the collective ML/TF/PF risks that have been identified within the life insurance sector. This report also provides stakeholders responsible for drafting

[1] https://www.resbank.co.za/content/dam/sarb/publications/media-releases/2020/pa-sector-risk-assessment-summaries/Insurance%20Sector%20Assessment%20Executive%20summary.pdf

legislation on anti-money laundering and countering the financing of terrorism (AML/CFT) with more insight into the practical outcomes identified in the current AML/CFT regime within South Africa.

This report may guide policymakers, notably National Treasury (NT) of the Republic of South Africa, insofar as it provides ML/TF/PF risk information that could affect future policymaking positions relating to the life insurance sector. It will also benefit life insurers by helping them to better understand ML/TF/PF risks in the life insurance sector as well as to review and update their own risk assessments.

3. AML/CFT framework

The PA is responsible for regulating banks, mutual banks, life insurers, non-life insurers, cooperative financial institutions, financial conglomerates and certain market infrastructures. The responsibilities of the PA include supervision of compliance with the Banks Act 94 of 1990, as amended; the Mutual Banks Act 124 of 1993; the Co-operative Banks Act 40 of 2007; Prudential Standards; and the Insurance Act 18 of 2017; as well as the financial supervision of the Road Accident Fund Act 56 of 1996. In terms of section 45 of the FIC Act, it is the responsibility of the PA as a supervisory body in terms of schedule 2 of the FIC Act to ensure that it supervises and enforces compliance with the provisions of the FIC Act by pertinent accountable institutions.

4. Overview of the life insurance sector

As at 31 December 2020, the life insurance sector in South Africa consisted of 60 primary life insurers, 5 life cell captives, 1 life reinsurer and 5 composite reinsurers. The total asset size of the sector was R3 290 billion, with gross premiums written totaling R575 billion.

Figure 1: Industry lines of business (composition %)

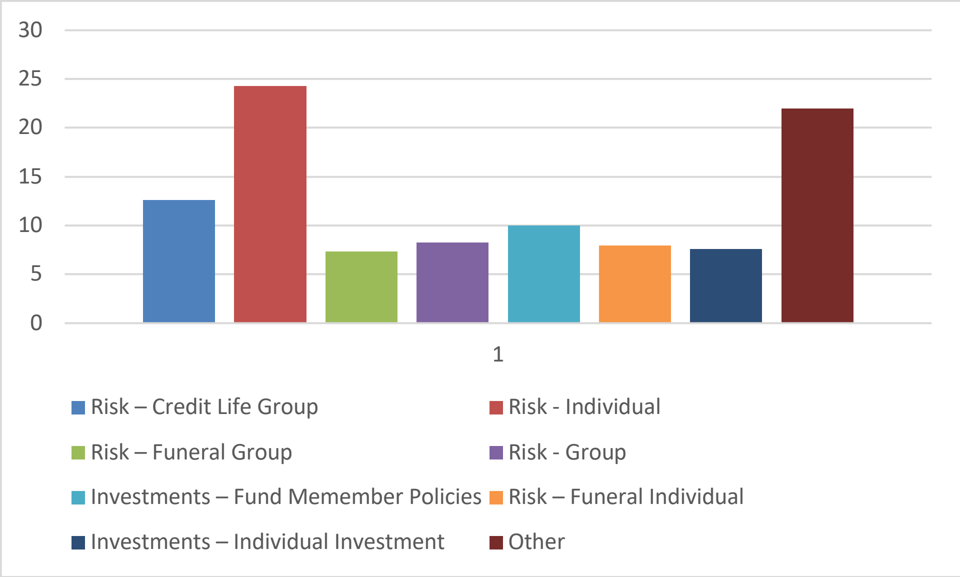


Table 1: Top 10 life insurers in respect of asset size

Insurer	Assets (R'000)
Insurer A	704 819
Insurer B	569 230
Insurer C	403 554
Insurer D	379 783
Insurer E	308 793
Insurer F	179 289
Insurer G	145 565
Insurer H	107 722
Insurer I	87 557
Insurer J	47 941

Figure 2: Life insurance market share

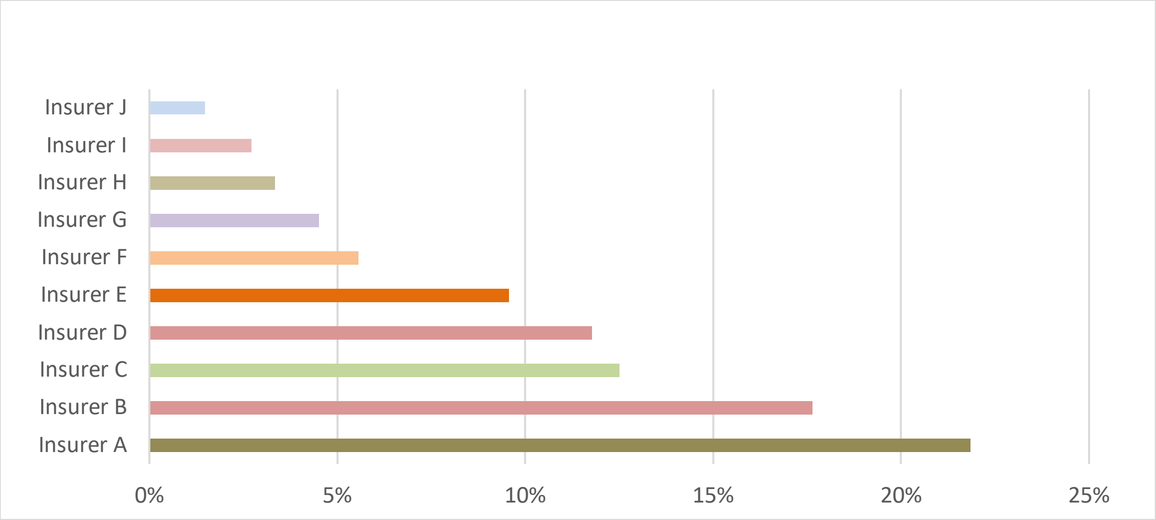


Table 2: Policies in force premiums per class of business (R'million)

Risk - Individual	253 554
Risk - Grouped Individual	22 860
Risk - Group	85 026
Risk - Credit Life Individual	16 657
Risk - Credit Life Grouped Individual	31 584
Risk - Credit Life Group	129 056
Risk - Funeral Individual	82 538
Risk - Funeral Grouped Individual	37 716
Risk - Funeral Group	82 370
Life Annuities	10
Investments - Individual Investment	75 673
Investments - Fund Member Policies	102 200
Investments - Fund Investment	35 503
Investments - Income Drawdown Investment	684
Combined Policies - Universal Life	49 336
Combined Policies - Fund Member Policies	2 021
Total	**1 006 788**

Table 3: Top 10 life insurers in respect of premiums

Insurer	Premiums (R'million)
Insurer A	92 914 717
Insurer B	68 110 413
Insurer C	59 420 290
Insurer D	53 980 232
Insurer E	48 983 793
Insurer F	30 754 366
Insurer G	26 172 992
Insurer H	22 007 729
Insurer I	21 247 245
Insurer J	20 528 814

5. Methodology

In April 2021, the PA distributed a questionnaire to 60 primary life insurers and five life cell captives to determine the level of ML/TF/PF risk in the insurance sector. Quantitative and qualitative data was collected through the survey. Fifty-five primary life insurers and three cell captives completed and returned the questionnaires to the PA.

The PA analysed the responses received and considered the information emanating from AML/CFT inspections that were conducted. Additional information was obtained from open sources, published research and publicly available annual reports. Information obtained from the FIC on reporting of transactions in the insurance sector was also considered.

The survey requested a range of information, including statistical data on reporting duties and informative data pertaining to ML/TF/PF risks that may be present within a life insurer by virtue of factors such as its products, delivery channels, geographical location, customer risk and industry. The main focus of this assessment is inherent risk exposures within the sector. Mitigating controls were not taken into account.

The methodology used in this risk assessment is based on FATF guidance which states that risk can be seen as a function of three factors, namely threat, vulnerability and consequence:

- **Threat** refers to the nature and extent of ML/TF and relevant predicate offences in the insurance sector.
- **Vulnerability** refers to the characteristics of major insurers that make them attractive for ML/TF purposes.
- **Consequence** refers to the impact or harm that ML/TF activity within the insurance sector may cause.

The sector was assessed in terms of several factors across threats, vulnerabilities and consequences. Each factor was weighted and a risk score allocated for each category.

Table 4: Category of risk and risk score

Criminal threat environment	**Risk score**
Low	1
Medium	2
High	3
Vulnerability	**Risk score**
Low	1
Medium	2
High	3
Consequence	**Risk score**
Minor	1
Moderate	2
Major	3

6. Limitations

There is limited publicly available statistical information on ML/TF/PF risks specific to life insurers in South Africa and work is currently underway in this regard. Some of the life insurers did not have some of the statistical information that was requested, and some provided inadequate responses to the questions posed.

7. Criminal threats

7.1 Money laundering

ML through life insurance institutions is often performed to disguise the origin and nature of illegal proceeds of crime and gains obtained from it by buying, altering and surrendering insurance policies and filing insurance claims to avert the tracing of the origin of the funds. Life insurers may be vulnerable to money launderers which can be attributed to the characteristics of the insurance business, such as paying costly commission to buy insurance policies with illegal earnings and then selling the policy, and converting the illegal property by repeatedly trading it to break its tie with crime.

Business segments within the life insurance sector – such as onboarding teams, servicing teams and finance departments – are the most exposed to ML risk due to their level of engagement with the policies and the client.

The following factors also contribute to the appreciation of ML risk at life insurers:

- dealing with politically exposed persons (PEPs) and/or sanctioned individuals;
- conducting business with complex customer types such as companies and trusts;
- conducting business with customers whose preferred mode of payment is cash;
- inadequate identification of the origin of funds;
- conducting business with unscrupulous financial advisers;
- engaging financial advisers who reside outside South Africa;
- the nature, complexity and type of product may increase the ML/TF and sanctions-related activities;
- instructions from third parties;
- mode of payment;
- unauthorised/material transactions;
- requests for refunds;
- high-value investments;
- high-risk individuals (repeat investments from the same customer, paying the required amount in various amounts);
- early terminations of investment products;
- use of an intermediated model;

- cash deposits;
- payments by high-risk third-party individuals;
- nomination of high-risk beneficiaries;
- identity fraud;
- undetected employee engagements in ML; and
- wilful blindness.

Life insurers indicated that the following factors could suggest a high risk of ML:

- fraud risk, which could branch out to ML risks;
- accepting payments in cash (e.g. when direct debits bounce);
- allowing for payments from third parties;
- receiving and making payments to other jurisdictions;
- accepting over-payments;
- a life product wrapped with investment or savings;
- accepting payment of premiums outside the premium schedule;
- a single premium:
  - may be targeting high net-worth individuals; and
  - allows for large single lump-sum payments, which could allow criminals to get rid of large sums of money in one go;
- risk profile changes;
- an early surrender after a policy is started;
- customers making large cash deposits as payment of premium;
- products that can be sold on non-face-to-face platforms;
- investment-type products:
  - can be ceded and transferred;
  - carry an investment value; and
  - provide high value of contributions and the ability to access funds;
- endowments: endowment contracts have a cooling-off period, allowing for the cancellation of a contract without much formality and the refund of monies paid;
- making cash deposits for the same invoice and splitting the amount:
  - any transaction involving an undisclosed party;
  - a premium payer erroneously paying an excessive premium as opposed to the invoiced amount and where this is not normal according to their known

annual turn-over; and

  - paying a premium in a complex manner (e.g. premiums change location/jurisdiction as frequently as they are made – this is done to avoid the transactor being traced;

- transparency is limited in respect of the source of the funds;
- products accessed without any restrictions or restricted number of withdrawals;
- there is a risk at claims stage; and
- layering is aimed at concealing the source of the money that was laundered through a series of transactions.

7.1.1 Use of cash in the life insurance sector

The use of cash in the sector is seemingly minimal. The majority of the life products underwritten by life insurers are designed in such a way that they cannot accept cash. Funds are thus received from policyholders by way of debit orders, and payments to beneficiaries are effected by means of an electronic fund transfer. However, reporting challenges are experienced when policyholders use non-descriptive or incorrect narrative on deposit slips at the bank or automated teller machines (ATMs).

Life insurers that do accept cash state that controls have been implemented to monitor:

- multiple cash deposits over a specified period;
- unmatched cash deposits where the depositor identifies him/herself and requires a withdrawal;
- excessive cash deposits;
- payments by customers of a minimum of R100 000 across all policies for the past 30 days and where more than 50% of the R100 000 was paid in cash; and
- the settlement of annualised premiums in cash, which is not expected in relation to the nature of the business or knowledge of the customer.

7.2 Terrorist financing

Based on the policies and procedures reviewed by the PA, it was found that the life insurers consider their TF risk to be lower considering the nature of their business and their product characteristics.

Life insurance entities indicated that their products are traditionally structured products subject to strict contractual provisions governing the business relationship, including transactions within the relationship between the life insurer and the policyholder. The contractual nature of life insurance products inhibits the ability of the policyholder to conclude transactions unilaterally as transactions require interaction with the insurer. This inherent inflexibility acts to significantly reduce the ML/TF risk associated with the client.

While life insurers filed suspicious and unusual transaction reports with the FIC, none was related to TF activities. Some life insurers provided information pertaining to general TF red flags. However, these red flags were not observed in the business environment of the institutions.

Most life insurers indicated that their products were low to medium risk from a TF perspective, and accordingly no red flags have been identified to date. Furthermore, customers are risk rated and enhanced due diligence measures are applied in respect of high-risk customers, including screening customers against relevant sanctions and targeted financial sanctions lists.

From the inspections that were conducted by the PA, it was noted that there were varying approaches to sanction screening of customers, beneficiaries, and so forth, and the frequency with which this is done.

The following factors may pose TF risk to life insurers:

- inadequate screening processes to detect sanctioned entities/individuals;
- conducting business with complex customer types such as companies and trusts located in high-risk jurisdictions or jurisdictions known to have high levels of TF activity or exposure;
- conducting business with customers whose preferred mode of payment is cash;
- inadequate identification of the origin of funds;
- conducting business with unscrupulous financial advisers;
- engaging financial advisers who reside outside South Africa;
- the nature, complexity and type of product;
- instructions from third parties;

- the mode of payment; and
- unauthorised/material transactions, including refunds.

A total of 63% of primary life insurers indicated that no TF risks have been identified due to the nature of their products and the low risks associated with products such as funeral and credit life. Some primary life insurers identified the following factors as posing a TF risk:

- suitability of the product;
- type of customer invested in the product;
- minimums and maximums of the product;
- flexibility of movement of money;
- source of funds;
- delivery channel;
- type of customer;
- transaction type;
- financing terrorism;
- criminal, legislative or regulatory action;
- reputational damage or loss of confidence;
- defined event;
- cash payments;
- third-party payments;
- payment to people on the TF sanctions list;
- investment products as the nature of the products pose a higher risk of ML/TF;
- transparency is limited in respect of the source of the funds;
- some products can be accessed without any restrictions or a restricted number of withdrawals; and
- there is a risk at claims stage.

Due to the varying degrees of controls in place from the institutions inspected, it is apparent that not all institutions conduct sanctions risk assessments, and not all life insurers understand their obligations to screen customers and the risk posed in terms of dealing with sanctioned beneficiaries or policyholders.

7.3 Proliferation financing

Most life insurers advised that they did not provide products or render financial services which could result in the use of their products or services in relation to any nuclear, biological or chemical weapons. Some life insurers were of the view that third-party policy beneficiaries could be involved in PF activities. However, as a mitigating factor the life insurers indicated that they also screen policy beneficiaries against group approved sanctions lists. Life insurers noted that the following issues could pose a PF risk to their businesses:

- customers that are involved in the supply and sales of military goods;
- state-owned entities;
- gambling;
- domestic prominent influential persons (DPIPs); and
- companies with complex shareholding structures.

Life insurers were of the view that considerations leveraged for ML, TF, fraud and sanctions were deemed sufficient to detect PF risk in the long-term insurance sector. One life insurer was of the view that PF requires high levels of funding and was therefore not a risk applicable to their business model.

PF red flags listed by some of the life insurers include:

- doing business with an entity that is involved in the manufacture, shipment or trans-shipment of dual use goods, arms and other weapons;
- customer behaviour and a match against sanctions lists;
- countries with weak financial safeguards and that actively engage with sanctioned countries;
- individuals or entities with interests in countries with PF concern;
- customers that are involved in the supply and sale of military goods;
- customers with an address similar to that of an individual/entity that is publicly available on sanctions lists;
- a customer that is a research body connected with high-risk jurisdictions with PF concern; and
- customers from high-risk jurisdictions.

Life insurers indicated that they use the following mechanisms to strengthen their counter-PF controls:

- product risk assessments;
- customer due diligence;
- enhanced due diligence;
- identification of PEPs;
- monitoring for adverse media;
- desirability assessments;
- ongoing screening of customers against sanctions lists;
- screening of beneficiaries against sanctions lists at pay-out;
- transactional monitoring;
- risk rating on geographic location/monitoring for TF and PF jurisdictions; and
- employee training.

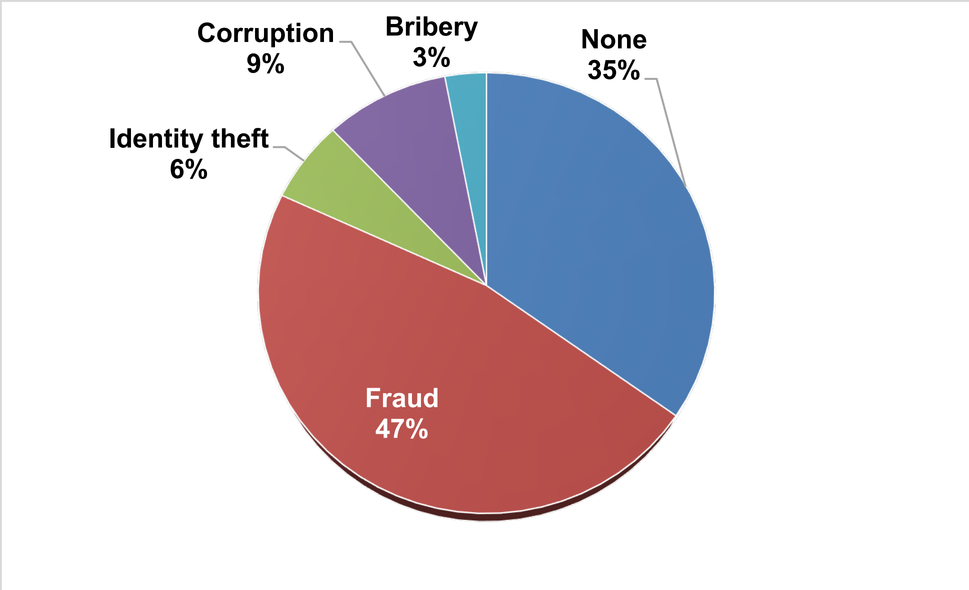
7.4 Predicate crimes

Most life insurers indicated that the crime that usually affects their businesses is fraud, followed by corruption and then identity theft (see Figure 3). Fraud is one of the top three indicators that were identified by the FIC as the reason for submission of suspicious transactions to the FIC. These predicate offences will have a direct impact on ML/TF/PF as they can essentially circumvent risk controls.

Certain life insurers advised that they were not affected by any crime in the past three years. The following fraud related matters were identified by some insurers:

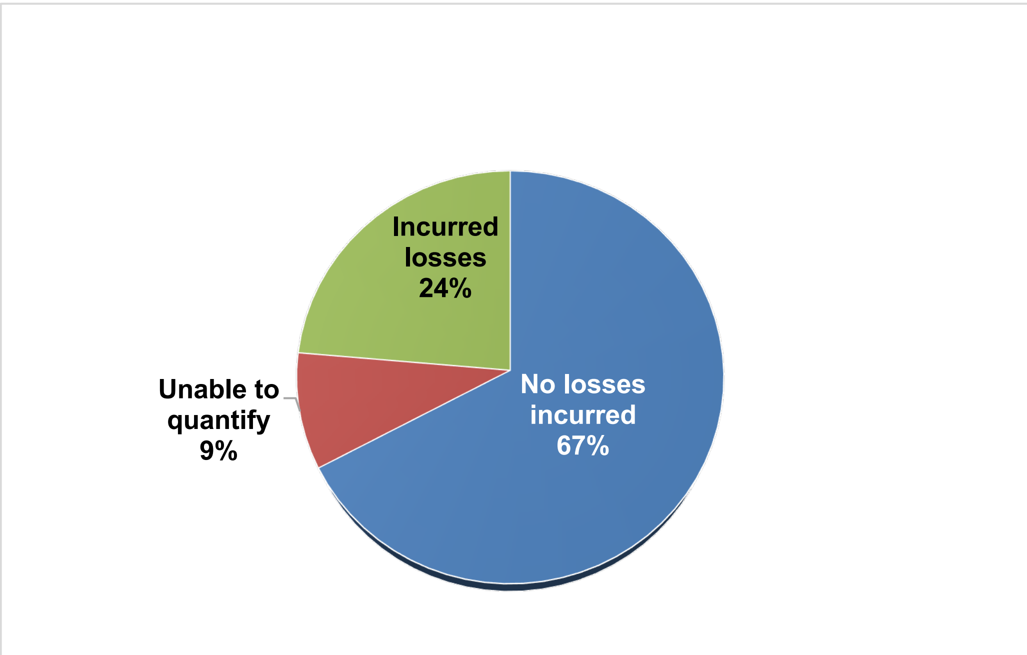
- falsification of documents;
- overclaiming or exaggerating benefits;
- dishonesty regarding insured events;
- false claims; and
- syndicates (e.g. operating in the group funeral space).

Figure 3: Percentage of insurers affected by predicate crimes and the types of predicate crimes that affected the life insurers



Most life insurers indicated that the crime mostly affecting their businesses is fraud (47%), followed by corruption (9%) and identity theft (6%). Some of the respondents advised that they were not affected by any crimes in the past three years.

Figure 4: Percentage of life insurers that incurred losses as a result of predicate crimes



Sixty-seven percent of the life insurers indicated that they had not incurred any losses as a result of predicate crimes during the 2019 and 2020 calendar years. Nine percent of the respondents advised that they were unable to quantify the losses incurred, while

24% indicated that they had incurred losses amounting to R144 million. Corruption and bribery are serious risks in South Africa that also play out in the life insurance sector.

The criminal threat environment of the life insurance sector has been assessed as **medium**, with fraud being the predicate crime that is most prevalent.

Table 5: Risk score for the criminal threat environment

Criminal threat environment	Risk score
Low	1
Medium	**2**
High	3

8. Inherent risk assessment

8.1 Customers

Generally, it was noted that some primary life insurers had not assessed or inadequately assessed the ML/TF/PF risks posed by their customers. For example, some insurers indicated that they did not perceive any ML/TF/PF risks in relation to their customers, given the nature of the insurer's business, although it was evident that there were factors that presented minimal risk.

8.1.1 Customer categories

In determining risk exposure as it relates to customers, various factors may be considered, including:

- customers residing in sanctioned countries;
- types of customers;
- prevalence of foreign-based customers;
- non-governmental organisations (NGOs);
- state-owned entities; and
- prevalence of high-risk customers such as foreign prominent public officials (FPPOs) or DPIPs.

Factors such as a high number of FPPOs and DPIPs may increase the risk to which institutions are exposed. Areas where there is a high number of customers who are considered risky therefore require attention and adequate mitigation measures to be implemented. The beneficiaries of policies held by customers may also pose a risk where these factors are present.

Twenty-four percent of the primary life insurers indicated that less than 5% of their business stemmed from customers located outside the borders of South Africa, while the remaining 76% of the insurers indicated that their customer base was solely in South Africa. In instances where foreign customers were onboarded, the majority of primary life insurers indicated that such customers were required to be residents of South Africa.

Table 6: Number of customers onboarded by life insurers

Total number of customers	Number of life insurers
1 – 10 000	13
10 001 – 100 000	11
100 001 – 500 000	13
500 001 – 1 000 000	6
1 000 001+	11

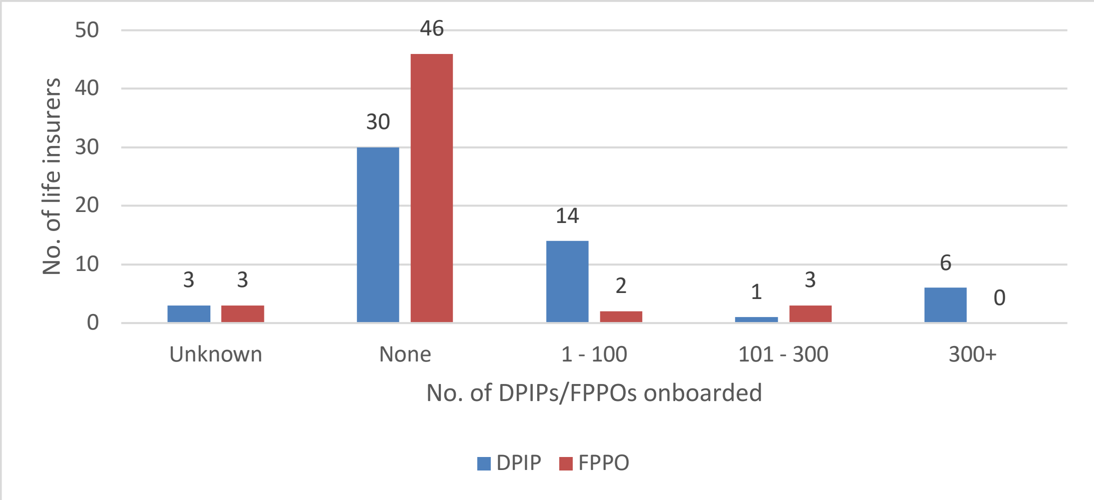
8.1.2 State-owned entities and politically exposed persons

The majority of the primary life insurers identified within the top 10 life insurers by virtue of asset size, indicated that they had established business relationships with state-owned entities.

The primary life insurers confirmed they have established business relationships with DPIPs and indicated that such relationships equated to only 1% or less of their customer base. Those who onboarded FPPOs had a commonality in that they had subsidiaries or alliances outside the borders of South Africa.

The cell captives that responded to the survey only have customers located in South Africa. One cell captive stated that the number of products per customer depends on the cell structure. However, the average is two policies per policyholder.

Figure 5: Number of DPIPs and FPPOs onboarded by life insurers



8.1.3 Customers vis-à-vis beneficiaries

Public Compliance Communication 48 of the FIC Act states the following:

> The information about the nominated beneficiary is part of the information relating to the client that needs to be assessed to understand client risk. Therefore, an accountable institution should have sufficient knowledge of the nominated beneficiary at any given time, so as to inform the understanding of ML/TF risk that is posed by the client.[2]

In addition to client types and categories, the beneficiary of a customer relationship may place an institution at risk. There are various scenarios where this can be seen, such as:

- where the insurer does not have sufficient information about the beneficiary to an insurance product or the beneficiary is unknown;
- where the beneficiary is not screened by the insurer at pay-out;
- where the beneficiary is a legal person and beneficial ownership has not been determined; and
- where the beneficiary is changed without the client giving the insurer reason for the change.

[2] This clause of the Act covers life insurance provider issues such as customer due diligence and understanding risk in relation to the client.

8.1.4 Customer behaviour

Customer behaviour as it relates to payments is also an area where ML/TF risk can be present. Factors that need to be considered include:

- the customer's source of funds;
- customers that pay using cash;
- a mismatch between a customer's wealth and income; and
- a mismatch between a customer's proposed premium amounts, deposit amounts or policy limits.[3]

8.2 Products and services

From the results of the survey, the total value of products per primary life insurer ranged from R60 000 to R520 billion. Most primary life insurers were in the category of R1 million to R1 billion. Ten respondents did not provide any values for reasons such as offering benefits only upon the death, disability, sickness or injury of the life assured, with no investment products (value driven) being offered, while some did not provide any reason.

The majority of primary life insurers indicated that their customers had between one and two products. Only 13% of the insurers stated that they offered high-risk products, while 87% stated that they did not have any high-risk products on their books.

Table 7: Products considered high risk by primary life insurers

1	Living annuity and endowment investment products
2	Guaranteed-return single-premium policy
3	Guaranteed-income single-premium plan
4	Savings and investment policies with recurring premiums of more than R2 500 per month and single premiums of more than R100 000 per month
5	Investment (living annuity)
6	Investment (linked)
7	Endowments and savings
8	Guaranteed-income plan
9	Guaranteed-growth plan
10	Group funeral

[3] https://www.iaisweb.org/uploads/2022/01/210517-Revised-Application-Paper-on-Combating-Money-Laundering-and-Terrorist-Financing-redline.pdf

Products were categorised as high risk for the following reasons:

- They have an investment component and are therefore subject to enhanced oversight and onboarding requirements.
- Investments and savings can be rapidly accessed. For savings, there is unlimited access to money and contributions can be flexible, thus policyholders can start and stop contributing whenever they want to without incurring a penalty.
- Endowment policies allow a one-off withdrawal during the first five years and contributions can be made at will (subject to regulatory limits).
- Investment, endowment and annuity-type policies were high risk as they involve larger sums than the other product offerings. Some products permit early surrenders and some products offer an option to pay out to a third party.
- Group funeral policies are considered high risk as fraud is common in the funeral industry.

One cell captive stated that it offers a range of white-labelled brands on the licence to sell predominantly pure risk life insurance business in the retail market. In most cases, policyholders would not have more than one policy under each of these brands. Customer value and risk profiles are also managed at a cell level. Another cell captive stated that it offers risk, funeral, credit life, investment (living annuity) and investment (linked) products.

Most products are largely accommodated by electronic fund transfers or debit orders. In relation to funeral products, some cell captives within a life cell captive insurer allow cash collection. None of these transactions exceeded R25 000. In terms of the average value of products, the sums insured vary across the class of business offered within the cells. One cell captive stated that it offers living annuity and endowment products, which it considers high risk.

Criminals prefer to use cash to facilitate ML. The use of cash for purchasing products in the insurance sector is discussed below.

8.2.1 Prevalence of cash

Ninety-four percent of the primary life insurers did not offer cash-intensive products, while 6% did. Sixty-five percent of life insurers did not offer non-pure risk products that could be surrendered before maturity date. Eighty percent of the primary life insurers did not offer non-pure risk products that could be surrendered within six months of an investment being made.

Common reasons provided for surrendering policies include:

- financial distress and access to funds;
- customer moving to another asset manager;
- maturity of the policy;
- reinvestment;
- access to built-up funds for living expenses;
- affordability and market movements;
- price competition, service and competitor benefits;
- economic challenges experienced by customers;
- surety call on loans;
- customer getting better rates at another insurer;
- settling of debt;
- education and college fees;
- personal reasons;
- death;
- customer needing the funds (if under Living Annuity Commutation limit);
- customer's savings goal achieved;
- customer unsatisfied with current insurer;
- purchasing of property;
- customer needs access to funds in an emergency;
- change in customer's investment strategy;
- customer's needs have changed; and
- product not performing according to expectation.

8.2.2 Limits on products

Thirty-seven percent of primary life insurers indicated that there are limits on the amount of money that can be invested per policy/product. Thirty-three percent indicated that this was not applicable and 30% indicated that they had no limits. This is concerning from a ML/TF inherent risk perspective because customers may elect to invest large sums of money, which may be out of line with the profile of the client held by the life insurer, and this may not be taken into account by the life insurer.

Eleven percent of primary life insurers indicated that their customers have the functionality to transact on any of their products independently of the insurer, while the rest (89%) of the insurers did not offer such products in their business.

8.2.3 Payments outside the regular schedule

Twenty percent of primary life insurers indicated that frequent payments outside the normal premium policy or payment schedule were possible. Eighty percent indicated that this did not take place in their business. The ability to make frequent payments outside of regular premiums is indicative of higher inherent risk.

8.2.4 Product flexibility

Seventy-two percent of primary life insurers indicated that they did not have products or services that offer a great degree of flexibility in terms of, for example, product usage and ease of access to funds. All the insurers indicated that they did not offer transactions where the beneficiary/recipient is anonymous. Seventy percent of primary life insurers indicated that they continue to service legacy products that have been discontinued, while 30% indicated that they did not service such products in their business.

A total of 63% of primary life insurers did not have products that target high-net-worth individuals. All primary life insurers indicated that no claims were rejected due to ML or TF reasons. Half of the life insurers had not rejected any claims due to fraud reasons. Three primary life insurers had rejected between 137 and 623 claims.

Table 8: Claims rejected due to fraud reasons

Number of primary life insurers	Number of claims rejected due to fraud reasons
13	1 to 10
5	12 to 31
6	58 to 100
3	137 to 623
27	None

Thirty-nine percent of primary life insurers did not reject any claims for other reasons. A total of 12 primary life insurers had the greatest number of rejected claims, with the number of rejected claims ranging from 2 037 to 45 437.

Table 9: Claims rejected for other reasons other than fraud

Number of claims rejected for reasons other than fraud	Reasons for claim rejection
46 763	• pre-existing condition • within waiting period • benefit definitions not met • policy lapsed due to non-payment of premium
	• suicide • non-disclosure • premium position not in order • waiting period • relationship restriction • late notification • no cover • no premiums received
	• declined claims (sickness, disability and critical illness) • no contribution received • deceased not covered • death occurred within the waiting period • pre-existing conditions, alcohol and suicide exclusions, contract workers, voluntary severance package • no insurable interest • still within waiting period or non-payment of premiums
	• non-disclosure, non-payment of premium, waiting periods and other reasons based on the insurance agreement • waiting period • misrepresentation • criminal act • death after lapse • assured deceased before commencement of policy • death before inception • deceased not covered • early retirement • foreign citizen • maximum age • medical restrictions • natural death on accident benefit • claim reviewed

	• no cash value for death claim • no insurable interest • over legal alcohol limit • suicide on accident benefit • suicide within two years of commencement of policy • unpaid premiums • non-disclosure on policy application • not insured on this policy • policy exclusions such as waiting period and lapsed policy • exclusion not covered • dismissal • policy cancelled • retirement • 30-day limit • hospitalisation not covered • individual not covered • voluntary retrenchment • waiting period (retrenchment) • retrenchment definition • main life not covered • lapses • no cover • no illness benefit • dependant not added

8.2.5 Client anonymity

A total of 98% of primary life insurers indicated that their products did not have the ability to mask or hide the customer's identity.

8.2.6 Products and services risks

Many life insurance companies are reporting exposure to financial crime, and ML in the insurance sector as a growing global problem. Due to the flows of funds into and out of their businesses, life insurers face the risk of ML because they offer highly flexible policies and investment products that offer opportunities for customers to deposit, and subsequently withdraw funds periodically.

Life insurers offer a range of products in the form of life policies, investment-type policies such as endowment policies and savings policies, and annuities. The ML risks associated with these products may vary considerably.

Certain products and services are regarded as having a higher risk for advancing ML. The most common products regarded as high risk include those that involve a high degree of flexibility and ability to withdraw cash with ease, such as investment-type life insurance products. Life insurers subject these products to enhanced oversight and onboarding requirements. Life insurers need to be vigilant and train staff and intermediaries to recognise potentially suspicious transactions. They also need to devote sufficient resources – such as IT capabilities – to detect and isolate such cases.

High-risk products and inherent ML/TF risks thereof as well as mechanisms identified as being vulnerable to ML include:

- The products are listed as high risk because they have an investment component and are therefore subjected to enhanced oversight and onboarding requirements. The product structure, however, does not facilitate ML and TF risks.
- Money in investment and savings products can be quickly accessed, making them attractive to money launderers.
- Savings policies provide unlimited access to money and contributions are flexible. Thus, policyholders could start and stop contributing whenever they want to without incurring a penalty, making it conducive for money launderers to offload their criminal proceeds and withdraw clean money. Penalties do not deter criminals as they are willing to incur a loss as long as they get a refund.
- Single-premium life policies allow money launderers to offload large amounts of money in a single transaction. Since these may also target high-net-worth individuals who might have access to large sums of illicit money, this product could be favourable to criminals. The source of funds should be scrutinised.
- Annuity policies or high regular premium savings: after paying premiums with criminal funds, money launderers can receive legitimate income from annuity policies or premium savings products. Debit orders can deliberately be made to bounce in order to use cash to pay premiums with criminal funds. Know-your-customer and screening processes should be in place.
- Endowment policies have cooling-off periods during which policyholders can request refunds of premiums without much formality or deliberately overpay premiums to trigger a refund. Money launderers can use this mechanism to further their agendas. Endowments also have a one-off access facility that allows a policyholder to withdraw from their policy during the first five years and make one-

off contributions at will (subject to regulatory limits).

- Early policy surrenders allow policyholders to cash out their policies with relative ease. Money launderers can exploit this by surrendering their policies at a loss to regain their deposited money. If a client is willing to incur a huge loss by paying a penalty to surrender the policy, this should raise a red flag for the life insurer.
- Top-ups: After paying a small initial premium to avoid regulatory attention, potential money launderers can top up their policy payments to offload more criminal funds.
- Transferring ownership: Customers can purchase life insurance policies and transfer ownership to a criminal third party who subsequently withdraws the money. Usually, investment-type policies allow for transfer of ownership. The life insurer has to identify and verify the new owner.
- Policy loans: After building up the policy's value with premium payments, money launderers can take out loans from their life insurance policy using its cash value as collateral. Policy loans do not involve stringent AML checks and do not have to be repaid – the value of the loan and interest will be deducted from the death benefit.
- Collateral: Life policies and in particular single-premium policies can be used as collateral for bank loans. Customers involved in ML can surrender their policies to their loans repay. Twenty-four percent of life insurers offer products that allow their customers to take out loans against funds held in linked investment-related policies.
- Group funeral policies were also found to be risky because of the industry in which they are sold.

Products offered in foreign jurisdictions

In the South African market, less than 10% of the life insurance industry offer products in foreign jurisdictions. Trading in foreign jurisdictions exposes life insurers to increased ML risks, particularly in jurisdictions considered a high risk due to factors such as a high crime rate, high rate of fake death claims and the presence of active terrorists. In such cases, enhanced oversight measures need to be considered.

Complex products

Complex products involve many layers. ML/TF risks to look for in such products include:

- making cash deposits for the same invoice and splitting amounts;
- a transaction involving an undisclosed party;
- a premium payer erroneously paying an excessive premium as opposed to the invoiced amount and where this is not normal according to their known annual turn-over; and
- paying a premium in a complex manner (e.g. the location or jurisdiction from which a premium is paid frequently changes to avoid the transactor being traced).

In the South African context, life insurers do not offer products that provide anonymity as this is prohibited in terms of the FIC Act.

Products mostly reported to the FIC for suspicious transactions or predicate crimes

All reports for the period 2018–2019 and 2019–2020 filed by companies in the long-term insurance sector were undetermined and without value for analysis due to the absence of identified predicate offences. This is an anomaly that warrants interrogation by the regulator.

Table 10: Cash transaction reports and suspicious transaction reports filed

Reports filed	2015/ 2016	2016/ 2017	2017/ 2018	2018/ 2019	2019/ 2020	Total	Average number of reports
Cash transaction reports	3 228	3 753	8 285	5 032	11 351	31 649	6 330
Suspicious transaction reports	11	6	22	71	214	324	65

Source: FIC

8.3 Delivery channels

8.3.1 Use of third parties: brokers and intermediaries

Based on comments submitted by primary life insurers, they do have products that are distributed through a broker or an intermediary or a combination of the two. The number of brokers or intermediaries varies from one to 14 465 per life insurer. Some insurers stated that they have independent financial advisers, brokers, tied agents, representative and binder brokers, and distribution channels via a bank (group business model) where a binder agreement is entered into with the bank. One life insurance group stated that certain brokers are shared within the group. Binder agreements are entered into with intermediaries under the Financial Advisory and Intermediary Services Act 37 of 2002.

Figure 6 depicts the percentage of brokers that the life insurers have outside South Africa. A total of 86% of the primary life insurers stated that they do not have brokers outside South Africa, 4% answered that they do and 10% stated that this type of business model is not applicable to their business.

Figure 6: Brokers located outside South Africa

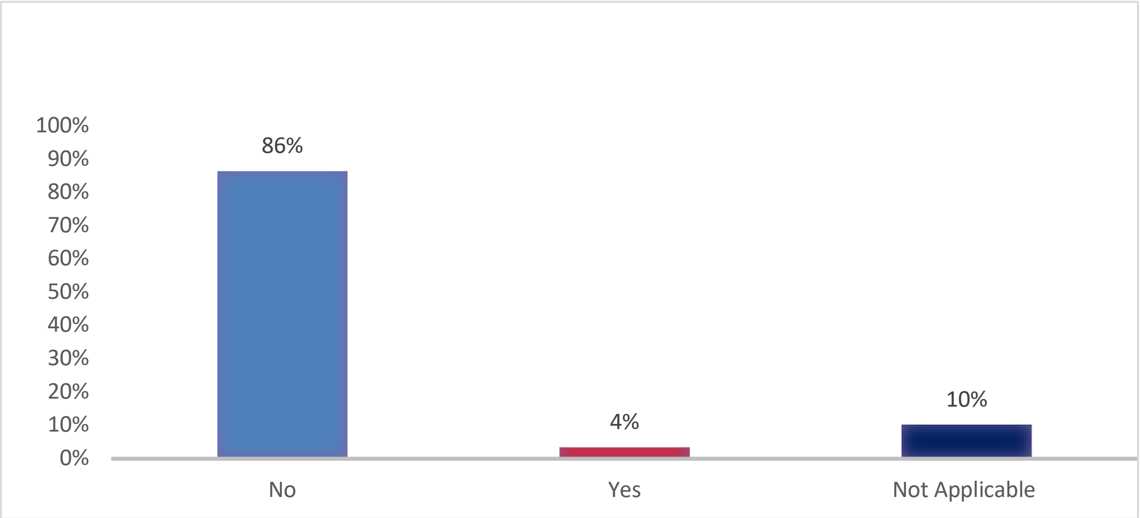


Table 11 shows the percentage of life insurers' business sourced through intermediaries or brokers (or the number of intermediaries or brokers). Some of the life insurers stated that they do not source business through brokers or intermediaries, while others stated that this type of business model is not applicable to their business.

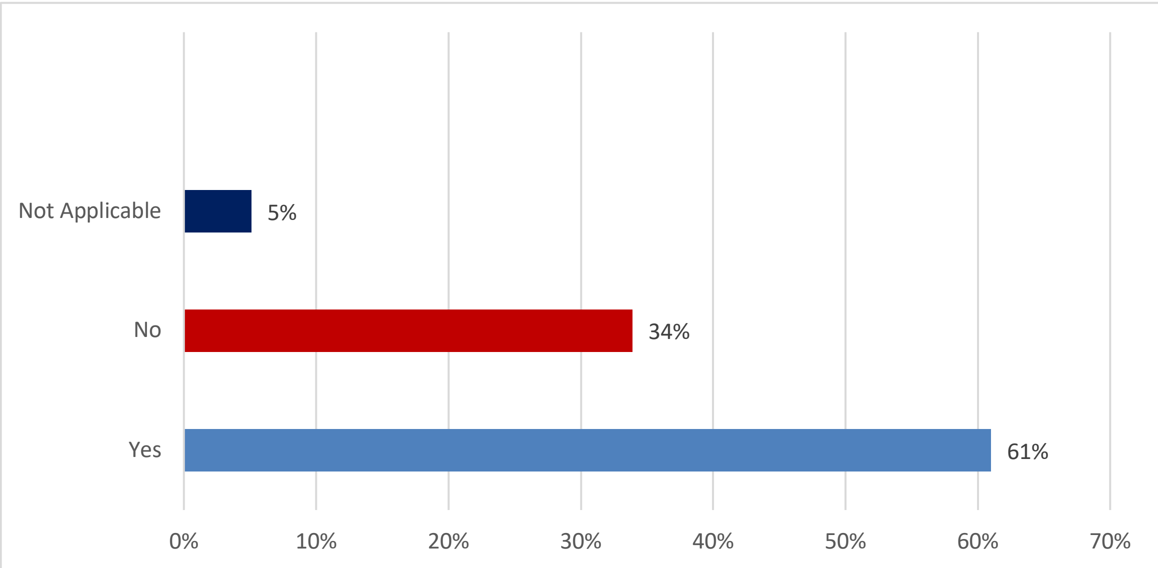
Table 11: Percentage of business sourced through intermediaries or brokers / Number of intermediaries or brokers

Insurer	Percentage of business sourced through intermediaries or brokers[4]
1.	46 (Risk products) 99 (Investment products)
2.	0.32
3.	1
4.	0.3
5.	0.95
6.	0.8345
7.	31.1
8.	1
9.	100
10.	83 (Intermediary business)
11.	0.41
12.	1
13.	0.91
14.	100 (through bank channels)
15.	0.03
16.	0.96
17.	97
18.	0.4
19.	0.14
20.	0.9
21.	0.06
22.	0.06
23.	98
24.	0.19
25.	1
26.	0.022
27.	Approximately 90
28.	100 (all policies are linked to a broker)
29.	0.87
30.	0.67
31.	0.99
32.	Less than 1
33.	0.3342
34.	0.1148
35.	1
36.	84
37.	99

[4] Life insurers excluded from this table include those that either responded with a 0, not applicable or a none response. Some Provided figures instead of percentages (i.e. the number of brokers).

Figure 7 depicts the number of primary life insurers whose delivery channels include offering products or services through walk-in or occasional customer service. One primary life insurer stated that in exceptional cases, a customer can sign an indemnity form so as not to have an intermediary linked to his/her policy. Sixty-one percent of primary life insurers stated that their delivery channels include offering products or services on a walk-in or occasional basis. Five percent of the primary life insurers stated that this service format is not applicable to their business operations. The reason provided by one insurer designated as a group is that they do not have a branch network. Only one insurer stated that it uses a combination of products and services offered to walk-in and occasional customers.

Figure 7: Insurers' delivery channels include offering products or services to walk-in or occasional customers



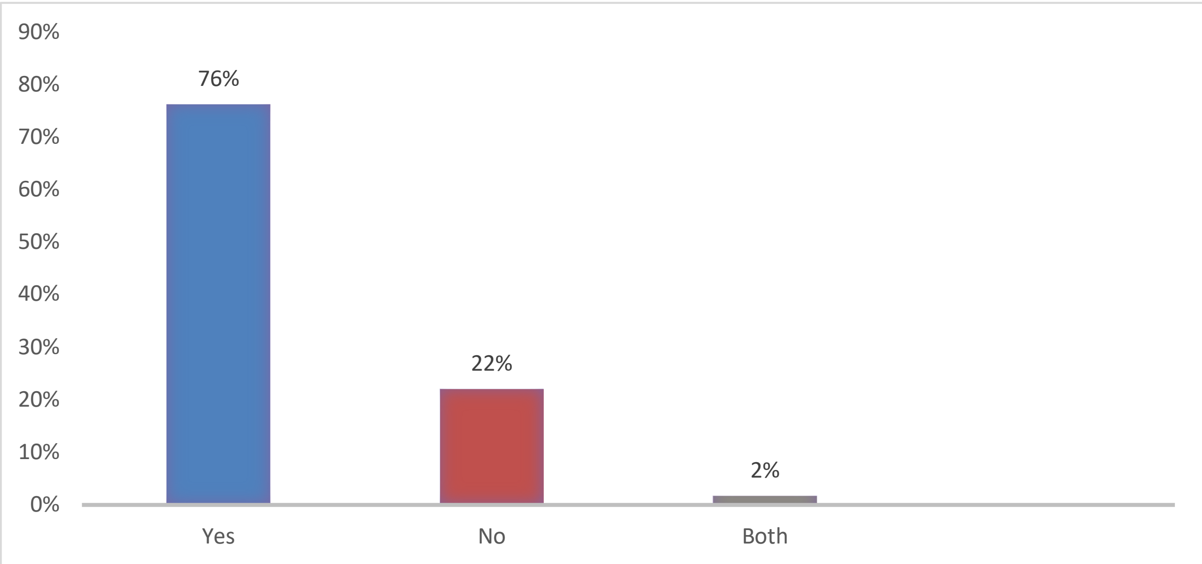
All primary life insurers surveyed stated that none of their customers interact or transact with intermediaries that are not subject to licensing and/or other regulatory requirements. One insurer stated that licence checks are performed against regulatory lists at onboarding and on an ongoing basis. It was further stated that licence checks involve being registered on a product and intermediary basis with the Financial Sector Conduct Authority.

A total of 71% of the insurers stated that they allow for usage of products or services independent of the insurer's system and transaction, while 24% do not allow such usage. This presents a risk in that the life insurer has no direct knowledge or control of the anticipated transaction unless it is linked to their system with governance protocol in place.

8.3.2 Customers onboarded on a non-face-to-face basis

Figure 8 shows insurers that source customers on an online or non-face-to-face basis. All the primary life insurers stated that the third parties that they use to engage or source customers are based in South Africa. Most of the insurers did not provide the area in which their third parties are located within South Africa or where most of their business is concentrated. Only one insurer stated that they have third parties centrally located in the Eastern Cape, Gauteng, Limpopo and KwaZulu-Natal.

Figure 8: Insurers that source customers through online or non-face-to-face means



Over and above the use of intermediaries, the cell captives indicated that they make use of representatives and binder holders. One cell captive indicated that it procures customers online or via non-face-to-face means and one insurer indicated that it uses a hybrid model.

8.3.3 Risks related to delivery channel

The PA has noted that life insurers use a variety of delivery channels. Most life insurers distribute their products either directly or through intermediaries and brokers, or through a combination of the two channels. Some insures have a footprint in foreign jurisdictions. Some life insurers use a direct method (i.e. a face-to-face, point-of-sale of a policy). A significant number of life insurers offer their products to the market on an intermediated basis.

Binder regulations in South Africa are fully enacted and regulated, which serves as a mitigating control measure to allow fit and proper binder holders into the market. It is common business practice in South Africa for life insurers to enter into binder agreements with third parties whereby a third party is given authority to underwrite a policy or as an intermediary with the following functions agreed to: enter into, vary or renew a policy; determine the wording, premium and value of policy benefits on behalf of an insurer; and settle claims on behalf of an insurer.

The compliance responsibility in terms of the FIC Act lies with the life insurer. A life insurer has the responsibility to exercise effective oversight over the binder holder on an ongoing basis, particularly in respect of measures to monitor risks that arise.

It is the responsibility of the life insurer to monitor, manage and report transactions resulting from the uptake of a product stemming from the business relationship entered into with a policyholder. Where business is sourced and entered into on a face-to-face basis without the involvement of a third party, the ML/TF risk is seemingly lower.

The PA identified the following risks linked to functions outsourced to a third party:

- lack of oversight by the life insurer regarding client identification processes and procedures followed by an intermediary or binder holder during the onboarding of a policyholder;
- poor management of policyholder information arising from conducting the insurance business via intermediated binder agreements/brokers;
- lack of documented and adequate governance, risk management and internal control frameworks in place in the business operations of the intermediary or binder holder which should highlight the ML/TF/PF risks arising from a business relationship entered into with a policyholder;
- complex outsourced functions, particularly relating to life insurers in foreign jurisdictions;
- reputational risk arising from inadequate control measures that are unable to identify ML/TF/PF risk during the onboarding of policyholders; and

- appointment of intermediaries and binder holders that are not fit and proper and lack understanding of ML/TF/PF risks.

Outsourcing functions can leave insurance companies vulnerable to new sources of risk and new threats, which includes ML/TF/PF risk from business-associated relationships with third parties that are sanctioned or have an inadequate understanding of the risk posed to the business by financial crime. These threats include loss of control over essential information for the management of the insurer.

Life insurers that rely on third parties through intermediary/binder holder agreements could find themselves non-compliant with the FIC Act. The life insurer is responsible for ensuring that the third party with whom it enters into an outsourcing agreement understands the ML/TF/PF risk exposure of the products offered. Furthermore, the accountable institution needs to ensure that the third party with whom it enters into a business relationship conducts targeted financial screening on policyholders onboarded against the relevant sanctions list, on beneficiaries when the policy is entered into, as well as on any other changes made during the life cycle of the policy and at pay-out stage. The life insurer bears the ultimate compliance obligations in terms of the FIC Act and therefore must ensure that the third party to whom functions are outsourced understands its reporting obligations in terms of section 28 and 29 of the FIC Act.

The failure of the life insurer to ensure that the third party understands and can explain ML/TF/PF risk can result in severe reputational risk for the entity, the sector and the country's FATF rating. Hence it is important that the life insurer ensures that a risk assessment is conducted, and the outsourced business partner understands the ML/TF/PF risk that the business is exposed to in terms of the type of products and services offered to policyholders. Failure to do so can result in a misalignment of the insurer's risk management and compliance programme (RMCP) when it is benchmarked to the third party's RMCP. Outsourced functions are inherently risky as the third party may not understand the compliance requirements and control measures in place to mitigate the ML/TF/PF risks that it is exposed to.

8.4 Geographical location

8.4.1 Areas of operation

Most primary life insurers stated that they do not have presence outside South Africa. Five insurers indicated that they have presence in Jersey, Bermuda, eSwatini, the Isle of Man, Guernsey, Mozambique and Kenya. Most of the insurers stated that they do not operate in jurisdictions where ML/TF is a primary concern. Only 2% of the insurers indicated that they operate in a location cited by FATF as having inadequate regulatory environments to combat financial crimes and that are favoured by money launderers, terrorist financiers and tax evaders, namely Botswana and Namibia.

8.4.2 Exposure to jurisdictions with specific predicate crimes

Nine percent of the primary life insurers indicated that they operated in one or more jurisdictions that had a greater exposure to drug trafficking, while 9% indicated that they did not. Seventy-eight percent of insurers indicated that they operated in one or more jurisdictions that had a greater exposure to corruption, while 22% indicated that they did not.

8.4.3 Provision of products to individuals in higher risk regions

Ninety-six percent of the primary life insurers indicated that they did not provide any products or services to individuals/entities residing in Syria, Sudan, Iran, Cuba, North Korea or the Crimea/Sevastopol regions of Ukraine. Two percent indicated that they did have a customer domiciled in Ukraine and another responded that this question was not applicable.

Sixty-three percent of the primary life insurers indicated that they did not have customers who were domiciled outside South Africa who interacted with them through intermediaries outside South Africa, while 4% indicated that they did (one said for retail customers only and another said it was one customer domiciled in Namibia who had appointed an independent financial adviser there). Thirty-three percent of insurers indicated that this was not applicable to them. Ninety-four percent of the primary life insurers indicated that they did not offer products in countries considered high risk by FATF, while 6% responded that this was not applicable to them.

The risks of engaging with an intermediary outside South Africa are inherently high as the intermediary may not apply due diligence to match the risk appetite of the policyholder.

The cell captives only have presence in South Africa and none offers products to customers residing in high-risk countries.

8.5 Geographical risks

The inherent risk of conducting business in FATF-sanctioned countries or jurisdictions that are under increased monitoring is not without consequence. An entity or individual that is knowingly or unknowingly doing business in a sanctioned country stands the risk of being fined or being sanctioned themselves. This will reflect negatively on the country in the case of a regulated/supervised entity. This reputational risk exposure may include:

- perceived failed AML/CFT regime;
- damage to brand and customer trust following an ML/TF incident that was not appropriately mitigated;
- strain on current and potential correspondent banking relationships;
- possible withdrawal of investment by domestic and foreign investors;
- significant potential harm to national and international security from TF; and
- enabling terrorist acts in South Africa and internationally.

In jurisdictions where there are known terrorist activities taking place, such as Mozambique and Kenya, where five life insurers indicated they have a presence, there is an inherent risk exposure. Weak AML/CFT controls in these accountable institutions may result in direct or indirect financing of terrorism in these countries.

The majority of the primary life insurers surveyed do not have customers in sanctioned countries or offer high-risk products. Most stated they do have products in their business that are distributed through brokers or intermediaries, but that they have controls in place. Most primary life insurers do not have presence outside South Africa. And while some primary life insurers have established business relationships with DPIPs, such relationships only equate to about 1% or less of their customer base.

8.6 Beneficiaries

The surveyed primary life insurers were asked to provide the number of their customers with known beneficiaries. They indicated a total number of 586 000 beneficiaries for all their customers. No insurer indicated that they have customers or policies with unknown beneficiaries.

Seventy-two percent of the primary life insurers indicated that they did not ask their customers to provide reasons for changing beneficiaries, 22% indicated that they did and 6% said the question was not applicable.

A total of 72% of the surveyed insurers indicated that they performed sanctions screening on beneficiaries of policies at pay-out stage, 26% indicated that they did not and one entity indicated that this was not applicable to them.

8.7 Transaction risks

The PA considers those life insurers that accept cash from customers as presenting a high level of inherent ML/TF risk. Inspections conducted by the PA in 2019 revealed that some life insurers' processes provided for customers to deposit funds into a suspense account whereafter the life insurer would allocate the funds to the relevant policy or investment account. In some instances, the funds deposited included large amounts of cash. Although the PA found that the life insurers had processes in place to identify and file reportable cash transactions to the FIC, not all insurers had investigated such cash transactions to determine whether they should also be filed as suspicious and/or unusual transactions in terms of the FIC Act. Closer scrutiny of these transactions by the PA showed that the transactions may indicate placement of undeclared earnings in the financial system.

The PA deems the use of cash by customers to service premiums or payments in respect of insurance products as unusual and expects life insurers to implement processes to monitor such transactions.

The level at which life insurers are vulnerable to ML/TF has been assessed as **low**.

Table 12: Risk score for vulnerability to ML/TF

Vulnerability	Risk score
Low	**1**
Medium	2
High	3

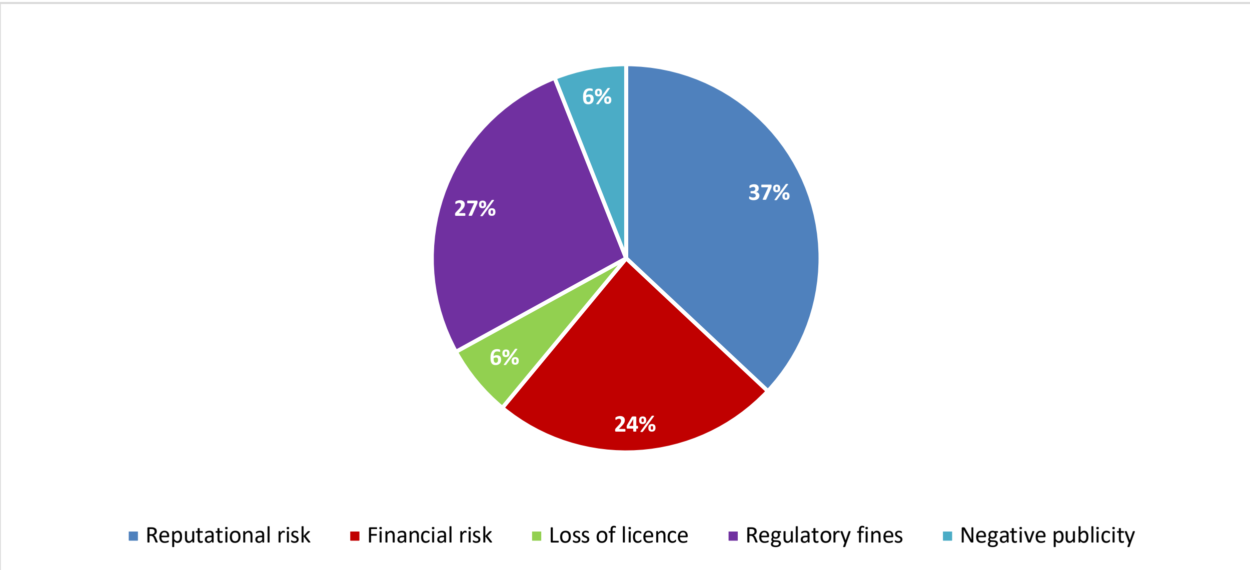
9. Consequences

ML activity can have major consequences for life insurers and their customers, including:

- reputational risk;
- operational risk;
- regulatory risk (non-detection and consequently no reporting of suspicious and unusual transactions); and
- employee risk (lack of skill in dealing with ML issues).

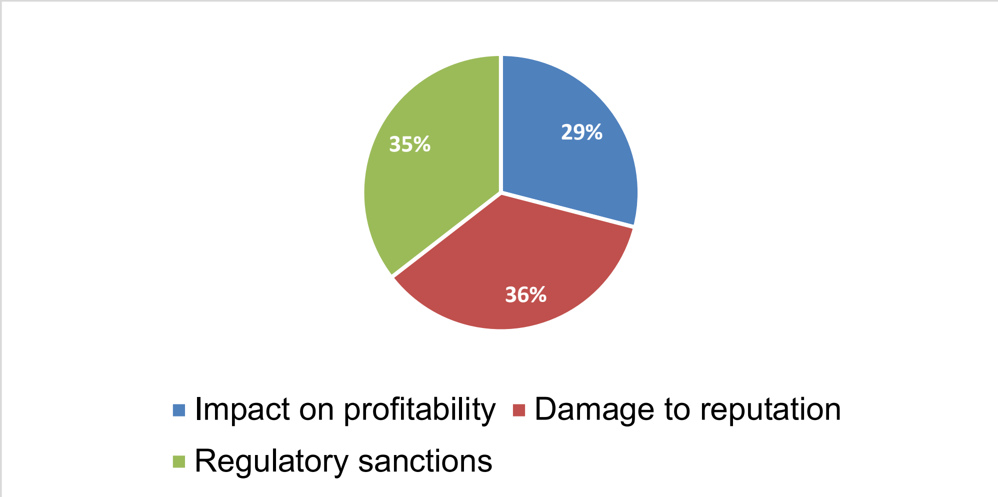
The surveyed life insurers stated that reputational risk was the key consequence that would affect them if they were found to be facilitating ML and that regulatory fines would have the most severe impact on their business operations (Figure 9).

Figure 9: Consequences associated with the risk of facilitating ML



Similarly, as shown in Figure 10, the insurers felt that reputational damage and regulatory action (e.g. fines) would have the most impact on their business should a TF event occur.

Figure 10: Consequences associated with the risk of facilitating TF



The ML/TF risk has been assessed as posing a **major** consequence to life insurers.

Table 13: Risk score for consequence of ML/TF risk

Consequence	Risk score
Minor	1
Moderate	2
Major	**3**

10. Conclusion

The responses and data obtained from the surveyed life insurers for this sector assessment were more comprehensive than that obtained in 2019.

Based on its inspections conducted at life insurers, the PA has noted that taking into account all requisite factors as part of a risk assessment is key to ensuring that there is an adequate risk management and compliance programme in place at life insurers.[5]

The overall ML/TF/PF risk rating of the life insurance sector is **medium**. This rating is based on the assessment of the criminal threat environment, inherent vulnerabilities in the subsector and consequences associated with criminal threats.

[5] https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation/Administrative-sanctions