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Africa Insurance Outlook 2022

The FATF Report: what you need to know

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The FATF Report: what you need to know

The Financial Action Task Force (FATF) recently released its 2021 Mutual Evaluation Report for South Africa. The FATF's findings show clearly that South Africa needs to significantly improve its practices and processes with regard to countering money laundering and terrorist financing. FATF has also made it clear that it believes the large banks have established better practices and processes than the rest of the Accountable Institutions, and accordingly there is a need for the insurance sector to reassess and refresh their responses to financial crime. In light of this, it is perhaps not surprising that in 2021 the South African Reserve Bank fined more insurers than banks for financial crime compliance weaknesses.

While the FATF's report contains a wide range of findings and recommendations, we will look at four key focus areas highlighted by the FATF that require immediate improvement.

Risk-based approach

According to the FATF most financial institutions show an acceptable understanding of their anti-money laundering (AML) and counter terrorist financing (CFT) obligations. However, beyond the large banks, most demonstrate a largely rule-based, compliance-focused approach. A focus on compliance, rather than a truly risk-based approach (RBA) is likely to result in too much emphasis being placed on the client, with insufficient attention paid to other risk factors such as products, sectors and geographies. The report also voices the concern that RBAs are not systematically updated, and so they are potentially under-assessing emerging risks. An RBA which is static and reactive, rather than dynamic and proactive, may lead to important risk triggers being missed.

Where the RBA is underdeveloped, so are the risk management plans and, as a consequence, also the mitigation measures implemented. In these cases, the approach usually results in missing the intent of identifying true high-risk areas and implementing controls and mitigation measures that target these directly. The suggestion from the FATF report is that RBAs need to be refreshed periodically to ensure that they adequately and comprehensively reflect and address the organisation's AML and CFT inherent risks. The refreshed RBA should then result in amended risk management plans and more effective control of financial crime risks.

The products offered by insurers are often not considered to be of high risk to money laundering and terrorist financing due to the delays between the premium payments and the eventual claim which often reduces the benefit of integration in the money laundering process. Nevertheless, the products do still share several key features such as: reliance on intermediaries, policies that can be used as collateral for loans, high value products, numerous parties to the contract (the insured, the premium payer, the claimant), lack of frequency of client contacts and multiple hand-offs in the pay-out process.

Further, the process of insurance also has wide ranging impact, from insuring of illegal goods, the sales-driven nature and incentivisation of brokers and limited oversight and control over intermediaries and their processes from the perspective of financial crime.

Beneficial ownership

There is a well-known challenge with identifying and verifying ultimate beneficial ownership (UBO) of juristic customers and obtaining evidence of this. This is primarily driven by the lack of publicly available information in this area, and hence organisations often simply rely on customer disclosures. The result, however, is generally weak UBO data and controls. This in turn increases the risk of companies and the misuse of trust structures. There have been some attempts to improve this assessment by assessing fund flows and undertaking behavioural analytics, but weaknesses remain. The critical question is whether insurers, in the absence of acceptable UBO data, will refuse to onboard a customer? The policy of the organisation should be clear and formal, and both staff and most importantly, intermediary training should be aligned.

While Government is assessing its role in improving the public recording of entity ownership information, all insurers should consider improved mechanisms to collect UBO data and must train staff on these mechanisms, especially where complex structures are involved.

Identification of UBO is often problematic for insurers as these are often only parties to the contract once the actual payment of the claim is processed. In such cases, and provided insurers implement strong and effective controls, insurers could potentially delay the identification and verification of these parties, provided no payment is made until the UBO is identified and verified.

Politically Exposed Persons

Given the experience of South Africa with state capture and corruption, the FATF highlighted the issue of Politically Exposed Persons (PEPs) as a key risk. It was specifically noted that there are weaknesses in the PEP identification processes, and these often emanated from the PEPs occurring at provincial and local, rather than national, level. Provincial and local PEPs are typically not covered on traditional lists contributing to this weakness.

Critically assessing the completeness of an insurer's PEPs checklists is an important risk mitigation measure. In this context, the legislated timeline needs to be disregarded and an adage of 'once a PEP, always a PEP' should be applied.

Transaction monitoring

Transaction monitoring (TM) observations are mixed, and while many entities generate a good number of alerts, others are almost exclusively focused on monetary limits. A balance is required between generating adequate numbers of alerts and ensuring that they are based on effective scenarios. An overreliance on generic system-based scenarios will lead to weak alert data. The value in the process is intentionally assessing valid alerts, rather than simply going through the process.

From an insurance company's perspective, this always remains a challenge as most TM solutions on the market have limited scenarios that are focused on insurance transactions, and rather focus on the typical transactional accounts for banks. However, there are a number of innovative solutions developed by fintechs that are becoming more robust and widely available to handle these issues. It is important that the selection of a solution is performed in line with the risk assessment and risk-based approach to ensure that there is alignment, and the risk is appropriately managed. We believe that monitoring of insurance contract transactions for financial crime could be considered and performed as part of the process when considering claims fraud. While claims fraud is a different set of risks to money laundering and terrorist financing, it is an area where insurers have a very good understanding, and it can be used as a strong foundation for managing financial crime risk more broadly.

The FATF report findings highlight disappointing results for South Africa, as it introduces the real risk of a grey listing. While the South African government understands that there are aspects it needs to correct, it will also require stronger cooperation between Accountable Institutions and law enforcement. Two things are clear from the report. The first is that the FATF have provided some clear indications of where the areas of weakness are, and second, there is no doubt that the Regulator will be far more active at monitoring Accountable institutions' responses. The combination of these two is that the responsibility for reducing financial crime has increased for Accountable Institutions. Insurers will need to respond accordingly.

Ensuring the sustainability of the insurance sector

While the insurance sector might not be the most obvious one in the context of financial crimes, failure to strengthen preventative measures could undermine the sustainability of the sector. The FATF report provides a good starting point as it identifies key weaknesses of the current system and offers recommendation on how to strengthen it. Stronger cooperation and alignment between law enforcement and insurance companies will be necessary to tackle the risk of financial crimes. Further, the government will need to address certain weaknesses from a regulatory/legislative perspective. This will likely increase the responsibility of Accountable Institutions to be more active in their response to financial crime risks.

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