#8

December 16, 2002

FinCEN
P.O. Box 39
Vienna, VA 22183
ATTN: Section 352 - Insurance Company Regulations

RE: Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations - Requirement That Insurance Companies Report Suspicious Transactions

Dear Sir or Madam:

On October 17, 2002, the Financial Crimes Enforcement Network ("FinCEN"), U.S. Department of Treasury, issued a proposed rule relating to the reporting of suspicious transactions by insurance companies.[1] The proposed rule amends the regulations implementing The Bank Secrecy Act ("BSA")[2] and requires insurance companies to report suspicious transactions to the Department of the Treasury.

This letter of comment on the proposed rule is respectfully submitted by the National Association for Variable Annuities ("NAVA")[3]. NAVA and its member organizations strongly support the development of effective rules for insurance companies to combat

[1] Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations - Requirement That Insurance Companies Report Suspicious Transactions, 67 Fed. Reg. 64067 (October 17, 2002)(the "Release")

[2] Public Law No. 91-508,as amended, codified at 12 U.S.C. 1829b, 12 U.S.C. 1951-1959, and 31 U.S.C. 5311-5332.

[3] NAVA is a not-for-profit organization dedicated to increasing public knowledge and acceptance of annuities and variable insurance products. NAVA's mission is to promote the growth, acceptance and understanding of annuity and variable life products to retirement-focused Americans; to provide educational and informational resources to its members and the public; to protect consumers by encouraging adherence to the highest ethical standards by insurers, distributors and all other participants in this diverse industry; and to protect and advance the interests of its members. NAVA represents all segments of the annuity and variable life industry with over 350 member organizations, including insurance companies, banks, investment management firms, distribution firms, and industry service providers.

11710 Plaza America Drive, Suite 100 Reston, VA 20190 ^ (703) 707-8830 ^ FAX (703) 707-8831

international money laundering and the financing of terrorism and have worked closely with Treasury to identify potential money laundering risks associated with the sale by insurance companies of variable annuity and variable life insurance contracts ("variable contracts"). However, several statements in the Release raise issues regarding variable contracts that we would urge FinCEN to address. NAVA appreciates the opportunity to offer the following comments on the proposed rule.

1. Definition of Insurance Company

The proposed rule defines the term "insurance company" to mean

> "any person engaged within the United States as a business in:
> (A) The issuing, underwriting, or reinsuring of a life insurance policy;
> (B) The issuing, granting, purchasing, or disposing of any annuity contract; or
> (C) The issuing, underwriting, or reinsuring of any insurance product with investment features similar to those of a life insurance policy or an annuity contract, or which can be used to store value and transfer that value to another person."

We question the need to include the reinsurance of a life insurance policy or any insurance product with investment features similar to those of a life insurance policy or an annuity contract in the definition. The Release states that the definition of an insurance company reflects Treasury's determination that a suspicious transaction reporting requirement should be imposed on those sectors of the insurance industry that pose the most significant risk of money laundering and terrorist financing. The Release further states that FinCEN believes that the most significant money laundering and terrorist financing risks in the insurance industry are found in products that allow a customer to place large amounts of funds into the financial system and seamlessly transfer such funds to disguise their true origin. When an insurance company reinsures a policy issued by another company, there is no contact or privity between the reinsurer and the original customer, the purchaser of the policy. The customer of the reinsurer is, in effect, the issuing insurance company. This is akin to a pure casualty risk and casualty insurance is specifically excluded from coverage in the proposed rule. The primary insurance company would be in possession of all customer information and records and would have already screened the transaction for potential money laundering at the time the policy was issued. It would have also already filed a suspicious activity report if one was indicated by the circumstances surrounding the sale. We fail to see how the procedures and policies of the reinsurer at the time the reinsurance is issued could be expected to detect attempted money laundering by the original policy purchaser and further see no benefit in imposing a suspicious transaction reporting requirement on the reinsurer. With this

definition, reinsurers would be required to develop new and complete systems that would likely cost millions of dollars.

2. Insurance Agents and Brokers

The definition of an insurance company does not include insurance agents or brokers and, accordingly, agents and brokers are not required by the proposed rule to independently file reports of suspicious transactions. We generally agree with this exemption; any potential benefit from requiring each individual agent or broker to report such transactions would be outweighed by the costs.

We are concerned, however, that the proposed rule does not make a distinction between insurance products sold through insurance agents and brokers and insurance products sold through registered broker-dealers.

FinCEN acknowledges that many insurance products are sold through agents who, because of their direct contact with customers, are in a unique position to observe the kind of activity that may be indicative of money laundering. It also acknowledges that suspicious activity detected by the selling agent may not be information that is normally known by the insurance company. Nonetheless, the proposed rule places on the insurance company the responsibility for obtaining all the relevant information necessary from its agents and brokers for purposes of filing reports of suspicious transactions. As FinCEN explains, such information includes relevant customer information collected and maintained by the insurance company's agents and brokers, including observations and assessments by agents and brokers at the point-of-sale.

Placing the point-of-sale responsibility on the insurance company may be appropriate in situations where there is no other entity subject to anti-money laundering program and suspicious transactions reporting requirements involved in the transaction. However, we believe it is not appropriate or necessary in the case of the sale of variable contracts.

Variable contracts are securities and registered as such under the Securities Act of 1933. The variable contracts are funded by a separate account of the life insurance company that is registered as an investment company under the Investment Company Act of 1940. The Securities and Exchange Commission ("Commission") administers these acts and is the federal functional regulator for variable contracts issued by insurance companies.

Variable contracts issued by insurance companies are sold by a broker-dealer who must be registered under the Securities Exchange Act of 1934 and become a member of the National Association of Securities Dealers ("NASD"). Unlike unregistered insurance agents and brokers, registered broker-dealers are required to establish anti-money laundering programs.

On April 29, 2002, FinCEN issued an Interim final rule which implemented the requirement for the establishment of an anti-money laundering program contained in Section 5318(h)(1) of the BSA with respect to registered brokers and dealers.[4] The rule provided that a registered securities broker-dealer will be deemed in compliance with the requirements of Section 5318(h)(1) if it complies with the rules, regulations, or requirements of its self-regulatory organization concerning the establishment and maintenance of anti-money laundering programs. NASD Rule 3011 ("Anti-Money Laundering Compliance Program"), approved by the Commission on April 22, 2002, requires that the anti-money laundering programs shall, at a minimum:

(a) Establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under 31 U.S.C. 5318(g) and the implementing regulations thereunder;
(b) Establish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act and the implementing regulations thereunder;
(c) Provide for independent testing for compliance to be conducted by member personnel or by a qualified outside party;
(d) Designate an individual or individuals responsible for implementing and monitoring the day-to-day operations and internal controls of the program; and
(e) Provide ongoing training for appropriate personnel.[5]

Broker-dealers are also required to report suspicious transactions.[6] The Final rule on broker-dealer reporting of suspicious transactions requires the filing of a Suspicious Activity Report-Brokers or Dealers in Securities ("SAR-BD"):

- If a transaction is conducted or attempted by, at, or through a broker-dealer involving or aggregating funds or other assets of at least $5,000, and

- The broker-dealer knows, suspects or has reason to suspect that the transaction:
  (i) involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity;
  (ii) is designed to evade any requirements of this or any other regulation;
  (iii) has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the broker-dealer knows of no reasonable explanation for the transaction after examining

[4] Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Financial Institutions, 67 Fed. Reg. 21110 (April 29, 2002).
[5] Exchange Act Release No. 45798 (April 22, 2002).
[6] See Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations-Requirement that Brokers or Dealers in Securities Report Suspicious Transactions, 67 Fed. Reg. 44048 (July 1, 2002).

the available facts, including the background and possible purpose of the transaction; or
(iv) involves use of the broker-dealer to facilitate criminal activity.

Under the rule, broker-dealers are also required to retain a copy of the SAR-BD and the original or business record equivalent of any supporting documentation for a period of five years from the date of filing the SAR-BD. The broker-dealer's obligation to report suspicious transactions applies to the sale of variable contracts by the broker-dealer.

Proposed regulations have been issued which would require broker-dealers to develop and implement customer identification programs[7]. The proposed regulations for the customer identification program require a broker-dealer to obtain, at a minimum, a prospective customer's name, date of birth, address, and taxpayer identification number (or similar identification number for non U.S. persons). They further require the broker-dealer to make a record of all identifying information provided by a customer and copies of any documents relied on to verify the identity. All such records and documents must be retained until five years after the date the account of the customer is closed.

As previously noted, registered broker-dealers must be members of the NASD which has also issued a number of rules regarding the gathering of customer information. NASD Rule 3110(c) ("Customer Account Information") requires members to obtain certain information when opening an account, including: (1) the customer's name and address; (2) whether the customer is of legal age; (3) the signature of the registered representative introducing the account and the signature of the member or partner, officer or manager who accepts the account; and (4) if the customer is a corporation, partnership, or other legal entity, the names of any persons authorized to transact business on behalf of the entity.

NASD Rule 3110(c) also requires members to make reasonable efforts to obtain the following additional information prior to the settlement of the initial transaction in the account: (1) the customer's tax identification number or social security number; (2) the customer's occupation and the name and address of his or her employer; and (3) whether the customer is an associated person of another member.

Registered broker-dealers are further required under NASD Rule 2310 (the "Suitability Rule") to obtain customer information to ensure that a recommendation is suitable. In particular, the rule requires the broker-dealer to have reasonable grounds for believing that the recommendation is suitable for the customer upon the basis of the facts, if any, disclosed by the customer as to his other security holdings and as to his financial situation

[7] See Customer Identification Programs For Broker-Dealers, 67 Fed. Reg. 48306 (July 23, 2002).

and needs. Further, prior to the execution of a recommended transaction involving the purchase, sale or exchange of a security, the member must make reasonable efforts to obtain information concerning: (1) the customer's financial status; (2) the customer's tax status; (3) the customer's investment objectives; and (4) such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.

NASD Notice to Members 99-35 ("The NASD Reminds Members of Their Responsibilities Regarding the Sale of Variable Annuities") provides further guidance regarding the Suitability Rule and recommends that members make reasonable efforts to obtain comprehensive customer information, including the customer's occupation, marital status, age, number of dependents, investment objectives, risk tolerance, tax status, previous investment experience, liquid net worth, other investments and savings, and annual income.[8]

Thus, pursuant to both Treasury regulations under the USA PATRIOT Act and NASD rules, registered broker-dealers are required to gather abundant customer information prior to selling a variable contract that should enable them to verify the customer's identity and make a reasonable and informed determination as to whether the contract is being used to launder illicit money or finance terrorist activity. As a result, the broker-dealer has all of the relevant information about the customer and is the financial institution that is in the best position to detect and prevent money laundering at the time of the sale and to file a suspicious activity report with FinCEN in regard to any suspicious transaction.

Requiring insurance companies to obtain relevant customer information from the selling broker-dealers and also file suspicious activity reports at the time of the sale of a variable contract will result in unnecessary and expensive duplication on the part of both the insurance company and the broker-dealer.

Under this proposed rule, broker-dealers will be required to transmit copies of relevant customer information to the insurance company whenever they sell a variable contract in order for the insurance company to determine whether it needs to file a SAR. Independent broker-dealers typically sell the products of a number of insurance companies and may also find themselves subject to different requirements from different insurance companies in regard to the types of documents that must be copied and provided. This will result in significant costs to broker-dealers.

[8] The NASD has provided similar guidance with regard to variable life insurance contracts in NASD Notice to Members 00-44 ("The NASD Reminds Members of their Responsibilities Regarding the Sale of Variable Life Insurance").

Insurance companies also will incur significant expenses if required to maintain additional copies of the customer information and documents obtained by the broker-dealer and file suspicious activity reports for point-of-sale transactions. For example, one NAVA member insurer has estimated systems enhancement expenses for 2003, for gathering and storing customer identification data and red flag suspicious activity monitoring, will be $2,500,700, plus approximately 12,000 person hours in 2002 for analysis, design, drafting, training and process implementation. Moreover, we fail to see what benefits will be obtained by requiring insurance companies to file a report of the same suspicious transaction already reported by the broker-dealer at the time of sale.

Holding insurance companies responsible for obtaining all of the information collected by broker-dealers and banks – financial institutions already required to maintain anti-money laundering programs and file reports of suspicious transactions – will also eliminate the market efficiencies that have been developed in the industry. The result could be less prompt and accurate clearance and settlement of variable product transactions.

By way of background, in 1997, the National Securities Clearing Corporation ("NSCC") established a clearing process – named the Insurance Product Service or "IPS" – for annuity and life insurance sales. NSCC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (DTCC). DTCC is a holding company that was formed in 1999 by the integration of The Depository Trust Company (DTC) and NSCC. NSCC was established to take over the less risky but still highly paper- intensive clearance and settlement for the two major stock exchanges and the over the counter market in 1976. NSCC is now the leading provider of centralized clearance, settlement and information services to the financial services industry. NSCC is the leading processor of mutual fund orders.

IPS allows an insurance company to effectively and efficiently communicate with its broker-dealer and bank distribution channels. Under the system, broker-dealers and banks submit applications electronically through IPS to the insurance company. NSCC then settles the payments for the insurance products through its money settlement process. This electronic process allows the sale of variable products to be executed and settled in an efficient and timely manner, usually within one to three days of submission of an application.

In order for the process to work effectively, NSCC has developed, in consultation with the insurance industry, fields of data required in order to settle a transaction through NSCC. The information is limited to the information necessary to settle a trade such as name, address, date of birth and social security number of the customer and information regarding the broker-dealer or bank submitting the application. If an insurance company requires additional or different information than what is required by NSCC, NSCC will

transmit the information to the insurance company; however NSCC will not settle the transaction. Failure to settle the transaction results in cost and delayed settlement for the customer. Therefore, deviation from the NSCC data fields is discouraged.

Requiring each insurance company to determine what information it, individually, requires from each broker-dealer or bank within its distribution channels in order to satisfy anti-money laundering requirements will drastically limit the efficiency of IPS. Settlement of transactions could take longer and with potentially more risk of error because it would be completed outside of the electronic clearing system.

In addition, changing or adding information collected by NSCC is a very time consuming process. NSCC is a self-regulatory organization regulated by the SEC. Any change to the data collected by NSCC or the way that it conducts its business requires approval by the SEC and is subject to notice and comment under the Administrative Procedures Act, thereby making changes to the NSCC system difficult to accomplish in a timely manner.

To the extent that a company sells variable contracts through a registered broker-dealer, it should be permitted to rely on the anti-money laundering program of the broker-dealer to address suspicious transactions and risks at the time of sale and the broker-dealer's responsibility to file a suspicious activity report. The insurance company should not be required to obtain and duplicate the customer information gathered by the broker-dealer and to file a second suspicious activity report regarding the same transaction. This position is consistent with Treasury's risk-based approach to anti-money laundering programs for financial institutions generally.

3. Fixed Annuity Contracts

Many insurance companies also issue fixed annuity contracts. With a fixed annuity, the owner is guaranteed a specific rate of interest. Like a variable annuity, the owner can elect to receive an income stream over a period of time, with the dollar amount of each payment being fixed and guaranteed. Although not considered to be securities, fixed annuities are often sold by registered broker-dealers and banks. When sold by a registered broker-dealer, the broker-dealer typically requires that a new account be opened and the transaction is subjected to the broker-dealer's "know your customer" procedures. The fixed annuity transaction will also be subject to the broker-dealer's anti-money laundering program and the broker-dealer's obligation to report suspicious transactions. Fixed annuities sold through banks will likewise have been subjected to the bank's anti-money laundering program and its obligation to report suspicious transactions. In these instances, the insurance company issuing the fixed annuity should be able to rely on the programs of the broker-dealer or bank and not be required to duplicate the reporting of suspicious transactions.

4. Suspicious Transactions During the Ongoing Administration of the Variable Contract

NAVA recognizes that insurance companies issuing variable contracts are in a position to monitor for potential money laundering activities during the ongoing administration of the contract. These activities include exercise of free look rights, large investments followed by immediate withdrawal or surrender, loans from variable life insurance contracts, and changes in address, beneficiary or payee. Insurance company anti-money laundering programs should include policies, procedures and internal controls to monitor for such activities and insurance companies should file reports of suspicious transactions occurring during the ongoing administration of a variable contract.

* * * * *

Thank you for your consideration of our comments on the proposed rule. If we can answer any questions or be of further assistance, please call me at (703) 707-8830, extension 20.

Sincerely,

Michael P. DeGeorge
General Counsel