#24

November 25, 2002

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

RE: Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Insurance Companies

Dear Sir or Madam:

On September 18, 2002, the Financial Crimes Enforcement Network ("FinCEN"), U.S. Department of Treasury, issued a proposed rule relating to anti-money laundering programs for insurance companies.[1] The proposed rule prescribes minimum standards for anti-money laundering programs to be established by insurance companies pursuant to Section 352 of the USA PATRIOT Act.[2] ("Act")

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 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

[1] Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Insurance Companies, 67 Fed. Reg. 60625 (September 26, 2002)(the "Release")

[2] "Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001," Pub. Law No. 107-56 (October 26, 2001).

[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.

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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 annuity contract in the definition. The Release states that the definition of an insurance company reflects Treasury's determination that an anti-money laundering program 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 or contract issued by another company, there is no contact or privity between the reinsurer and the original customer, the purchaser of the contract. 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 contract or policy was issued. 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 contract purchaser.

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 establish an anti-money laundering program. We generally agree with this exemption;

any potential benefit from requiring each individual agent or broker to develop such a program 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 relevant information necessary to establish an effective anti-money laundering program. As FinCEN explains, such information includes relevant customer information collected and maintained by the insurance company's agents and brokers. Placing the responsibility on the insurance company may be appropriate in situations where there is no other entity subject to anti-money laundering program 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 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:

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[4] Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Financial Institutions, 67 Fed. Reg. 21110 (April 29, 2002).

(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 file suspicious activity reports ("SARs")[6] and proposed regulations have been issued which would require broker-dealers to develop and implement customer identification programs[7].

The Final rule on broker-dealer SARs requires reporting:

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

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

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

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 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]

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[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").

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.

Requiring insurance companies to obtain relevant customer information from the selling broker-dealers will result in unnecessary and expensive duplication on the part of both the insurance company and the broker-dealer. Broker-dealers would be required by the pending regulations mandating customer identification programs to maintain copies of documents used to verify customers' identities. Under this proposed rule, they will also be required to transmit copies of relevant customer information to the insurance company whenever they sell a variable contract. 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.

Insurance companies also will incur significant expenses if required to maintain additional copies of the customer information and documents obtained by the broker-dealer. 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, it is not clear how requiring the insurance company to obtain copies of the information gathered by the broker-dealer to verify the customer's identity will result in added protection against money laundering. For example, a copy of a government-issued identification bearing a photograph of the customer will not be of any value to the insurance company which never had any contact with the customer.

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 – 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.

The proposed rule requires an insurance company to make an assessment of the money laundering and terrorist financing risks associated with its products, customers, distribution channels, and geographic locations. To the extent that a company sells

variable contracts through an independent 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 should not be required to obtain and duplicate the customer information gathered by the broker-dealer. This position is consistent with Treasury's risk-based approach to anti-money laundering programs for financial institutions generally.

3. Delegation to Agents

We were pleased that the Release recognizes that insurance companies typically conduct their operations through agents and third-party service providers and that some elements of the compliance program will best be performed by personnel of these entities. While the Release states that it is permissible for an insurance company to delegate contractually the implementation and operation of those aspects of its anti-money laundering program to such an entity, the Release goes on to state that the insurance company remains fully responsible for the effectiveness of the program. This retained responsibility will render the delegation of little value since the insurance company would still be required to duplicate the efforts of the broker-dealer in order to satisfy its ultimate responsibility. We believe that in regard to delegation to third parties, insurance companies selling variable contracts through registered broker-dealers should be treated in the same manner as mutual funds were in the Interim final rule prescribing minimum standards for their anti-money laundering programs.[9] This rule does not hold the mutual fund that contractually delegates responsibility for aspects of its anti-money laundering program fully responsible for the effectiveness of the third party's procedures. Rather, it requires the mutual fund to obtain written consent from the third party ensuring the ability of federal examiners to obtain information and records relating to the anti-money laundering program and to inspect the third party for purposes of the program.

4. Variable Annuity Sales within Tax Qualified Plans

A significant amount of variable annuity sales occur within tax qualified plans[10], such as 401, 403(b) and 457 plans. Contributions to such plans are typically made through salary reductions or deductions or after-tax employee contributions. The contributions are put into accounts set up through the employer and the plans are subject to a number of statutory conditions and limitations. Withdrawals from such plans require plan trustee or employer authorization, and thus are not totally controlled by the participating employee.

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[9] See 67 Fed. Reg. 21117 (April 29, 2002).
[10] A qualified annuity is an annuity contract that is purchased in connection with a retirement program that receives special tax treatment under the Internal Revenue Code.

Variable annuities used to fund these plans do not lend themselves to use for money laundering. Given Treasury's risk-based approach to anti-money laundering programs, we believe that insurance companies should not be expected to scrutinize activities within these qualified plans to the same extent as individual accounts. This is the approach Treasury took with respect to mutual fund activity in omnibus accounts and we believe that the final rule for insurance company anti-money laundering programs should specifically recognize that the programs can have a more limited scope for such plans.

5. 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. Fixed annuities sold through banks will likewise have been subjected to the bank's anti-money laundering program. In these instances, the insurance company issuing the fixed annuity should be able to rely on the anti-money laundering programs of the broker-dealer or bank and not be required to duplicate these efforts.

6. Money-Laundering Risks 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.

7. Estimated Average Annual Burden Hours Per Recordkeeper

Finally, we believe that Treasury has drastically underestimated the amount of time that will be involved in collecting and maintaining the records required by the proposed rule. Treasury states that the estimated average burden associated with the recordkeeping requirement in the proposed rule is 1 hour per recordkeeper[11] per year. As discussed

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[11] "Recordkeepers" are described as insurance companies as defined in the proposed rule.

above, the Release states that each insurance company must obtain all necessary information to make its anti-money laundering program effective, including, but not limited to, relevant customer information collected and maintained by the insurance company's agents and brokers. Examples given in the Release of relevant customer information that insurance companies would be required to obtain include the method of payment for an insurance product and the degree of interest in contract features expressed by an annuity contract purchaser. As discussed earlier, insurance companies would also likely need to obtain copies of the information and documents obtained by the broker-dealer to identify the customer and verify his or her identity. Insurance companies would be required by the proposed rule to collect and store this information for each variable contract it issues. At the end of 2001, insurance companies were offering 523 different variable annuity contracts, which amounted for nearly $113 billion in sales.[12] Variable life insurance sales amounted to $5.9 billion from 170 contracts.[13] The recordkeeping burden on insurance companies as a result of the proposed rule will clearly be significant given this volume of annual sales.

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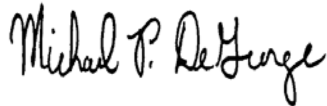
Thank you for your consideration of our comments on the proposed rule. If we can answer any questions or be of further assistance, please call me at (703) 707-8830, extension 20.

Sincerely,



Michael P. DeGeorge
General Counsel

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[12] See *Annuity Fact Book*, National Association for Variable Annuities (2002).
[13] Tillinghast VALUE Survey, Tillinghast-Towers Perrin.