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Mr Jonathan Curtis
Committee Secretary - Senate Legal and Constitutional Committee
Department of the Senate
Parliament House
CANBERRA ACT 2600

Dear Mr Curtis

INQUIRY INTO THE ANTI-MONEY LAUNDERING AND COUNTER-TERRORISIM FINANCING BILL 2005

Insurance Australia Group Limited (IAG) welcomes the opportunity to make a submission on the exposure draft *Anti-Money Laundering and Counter-Terrorism Financing Bill 2005* (**Draft Exposure Bill**).

On 7 March 2006 we made our initial submission to the Committee. The essence of this submission was to state that at that particular time, we were unable to provide definite details to the Committee in relation to our concerns with the Draft Exposure Bill.

Please find our supplementary submission attached.

IAG appreciates the opportunity to raise these important public policy matters in relation to the Draft Exposure Bill with you. If you wish to discuss this matter or make further inquiries please contact Justin Ward (Senior Adviser, Government Relations and Policy) on 02 9292 8253.

Yours sincerely

Dr Barbara Carney
Group Head – Government & Regulatory Affairs

Who is Insurance Australia Group?

IAG is the largest general insurance group in Australia and New Zealand (by reference to premium written in these countries). It provides personal and commercial insurance products under some of the most respected and trusted retail brands including NRMA Insurance, SGIO, SGIC, CGU and Swann Insurance in Australia, and State and NZI in New Zealand.

IAG's core lines of business include:

• Home insurance
• Motor vehicle insurance
• Business insurance
• Consumer credit insurance
• Product liability insurance
• Compulsory third party (CTP) insurance
• Workers' compensation insurance
• Professional risk insurance

IAG has a crucial interest in the long-term viability of insurance as a product valued by the Australian community. IAG believes that there are four principal ways in which the insurance industry can best meet these objectives. These are:

- investing in robust risk control frameworks and mechanisms that protect policyholders and provide certainty to shareholders;
- pricing products realistically;
- ensuring that customers understand what they are buying when they purchase a policy, and that products do not arbitrarily advantage or penalise particular individuals or groups; and
- committing to, and supporting, on a continuing basis, a comprehensive and clearly defined regulatory framework that facilitates more affordable premiums and more predictable claims costs.

What is IAG's Interest in the Draft Exposure Bill?

IAG's interest in this Draft Exposure Bill is multi-faceted and includes:

- ensuring that the Federal Government and other participants in the financial services sector have an appreciation of the low risk nature of the Australian general insurance sector in relation to money laundering. IAG does note that general insurance is not a designated service;
- ensuring the distinction between insurance fraud and money laundering is appropriately understood by both Government and regulators; and
- where appropriate, provide comment on the potential unintended consequences of the Draft Exposure Bill, that have the potential to effect the operations of businesses throughout Australia.

General Insurance – a low risk of money laundering

The general insurance industry in Australia employs approximately 43,000 people, issues more than 41 million insurance policies annually and deals with 3.5 million claims each year. Against this significant contribution the sector makes to the Australian economy, insurance fraud remains an important business risk that general insurers manage.

Insurance fraud in Australia can be placed into three broad categories, these being:

- opportunistic 'padding' or exaggeration of an otherwise legitimate claim (ie inventing items stolen in a genuine home burglary);
- premeditated fabrication of a claim; and
- fraudulent non-disclosure or misrepresentation of facts material to the insurance policy.

The direct cost to the insurance industry of paying false claims is largely passed on to policyholders in the form of higher premiums. However, the total cost does not end there - significant indirect costs are borne by the community, adversely affecting public services and consumer costs. Many Australian general insurers, including IAG, have programs in place to prevent, detect, monitor and investigate fraudulent claims activity. These programs include consumer education, analysis of fraud trends, individual case assessment and monitoring suspicious persons, as part of the claims management process.

IAG believes that managing insurance fraud within a general insurance entity is simply a component of managing the business risk. Risk investigations and cases of money laundering identified by the Financial Action Task Force (**FATF**), in relation to the general insurance sector, have tended to focus on insurance fraud (ie destruction of property, arson). It should be noted that in this example the premium paid to insure the property would have been a small proportion of the total sum insured. The fraud would have involved the potential payment of a large multiple of the initial premium paid to the insurer. Therefore to clean substantial amounts of money, a sophisticated and large scale operation involving the payment of premiums (representing insignificant proportions of the value of the potential claim) against real property and in some instance intangibles (ie professional indemnity insurance) would be required.

However in assessing the cost of accepting a risk, significant investigation of the underlying risk is conducted by the insurer. Certain obligations are placed on both parties in relation to disclosure under the *Insurance Contracts Act 1984*. An outcome of this piece of legislation is that the insured is required to provide correct information to the insurer, thereby allowing them to accurately assess the price (premium) of the underlying risk.

Money laundering is an attempt at turning "dirty" money into "clean" money. It is therefore difficult to launder large sums of money, at a discount to the initial 'dirty' money through the general insurance sector, particularly given the fraud control measures that general insurers have in place. In fact, general insurance has the opposite effect.

IAG contends that the general insurance sector remains at low risk to money laundering based on the following propositions:

- the low value of individual premiums associated with domestic (ie motor and home insurance) policies – in the case of IAG typically in the range of $500 – $1,000;
- a policy of utilising non-cash settlement for major claims. For example, when a house requires re-building IAG will engage the builder directly, resulting in financial transactions with the builder and other relevant contractors;
- whilst the premium associated with commercial/business policies has the potential to be large, significant analysis is undertaken by the underwriter of the risk, thereby fully understanding the background of the underlying risk;
- domestic and commercial insurance policies being placed with a typical duration of one year; and
- the typologies identified by organisations such as FATF (*Report on Money Laundering and Terrorist Financing Typologies, 2004 – 2005*), and International Association of Insurance Supervisors (IAIS) (*Guidance paper on anti-money laundering and combating the financing of terrorism – October 2004*) centre around cancellation of policies, overpayment of policies (with refund) and claims fraud – activities that IAG consider are all low risk.

Evidence emanating from Europe tends to suggest a similar view. Andy Wragg, Head of the International Regulatory Liaison Department at Lloyds of London, wrote in a Geneva Association publication in June 2005 the following:

"…General insurance traditionally is considered to face a significantly lower risk of money laundering than other financial sectors. This comparison even extends to the life insurance industry where a higher risk of money laundering is perceived due to the assumption that insurance products with cash value, such as single-premium life insurance policies or annuity contracts, are a preferred vehicle for criminals to launder funds…"

IAG also notes that in the FATF recommendations on anti-money laundering, general insurance should not be a designated service due to its low risk nature. We also note that the Draft Exposure Bill does not list general insurance as a designated service. This is consistent with the regulatory regime currently in place in the United Kingdom (*Money Laundering Regulations 2003*), The United States of America and the Third Directive (2005/60/EC) of the European Union. However, we note for completeness that general insurance firms in the United Kingdom are still subject to the general requirements contained in the Senior Management Arrangements, Systems and Controls module of the Financial Services Authority Handbook, the *Proceeds of Crimes Act 2002* (UK) and the *Terrorism Act 2000* (UK).

IAG agrees with the assessment of the Australian Attorney General's Department that general insurance should not be a designated service, due to its extremely low risk nature, an assessment that is consistent with the FATF recommendations.

IAG would support any proposal to discuss the issue of insurance fraud, and in particular the cost to the Australian community, with the Committee or representatives of the Australian Attorney-General's Department at a later date.

General Comments on Designated Services

Whilst general insurance is not considered a designated service we have some specific concerns relating to the designated services listed in section 6 of the Draft Exposure Bill.

These concerns include:

- **Item 1:** We are unable to comment until AUSTRAC publishes the relevant AML/CFT rules. However, we believe that general insurers should not be captured under paragraph (c) of the definition of "account provider".

- **Item 2:** IAG is of the view that this item be limited to an ADI, a bank or a person specified in the AML / CTF Rules, as per Item One. Alternatively, a definition of '"financial institution", similar to that used in the FATF Recommendations be utilised.

- **Item 4:** We are unable to comment until AUSTRAC publishes the relevant AML/CTF rules.

- **Item 5:** We are unable to comment until AUSTRAC publishes the relevant AML/CTF rules.

- **Item 6:** IAG believes that this item should be restricted to those who make loans in the course of a business relating to lending. The current Draft Exposure Bill could be interpreted to include companies that allow consumers time to settle bills, or in the case of IAG where cover notes are issued or recoveries from claims are outstanding.

  Regarding those who make loans in the course of a business relating to lending, IAG also believes that the nature of that activity needs to be considered. A company within the IAG group provides a loan product which enables commercial clients to pay their insurance premiums in instalments. The funds are provided to the relevant insurer either directly or through the insured's intermediary; they are not provided to the insured. This product poses very little (if any) additional risk to the underlying general insurance product as the funds can only be used for the purchase of general insurance.

  The meaning of "business" is very broad and could catch one-off or occasional activities.

- **Item 7:** See Item 6.

- **Item 21:** IAG believes the use of the term "stored value card" to be ambiguous because a definition of the term within the Draft Exposure Bill is incomplete. This makes it difficult for entities such as IAG to determine whether or not practices in which it engages to settle claims will be captured.

- **Item 32:** IAG is concerned about the ramifications of this particular designated service and in particular where general insurers offer consumer credit insurance ("**CCI**"). Many CCI products contain a life insurance component issued by a non-related entity. In some instances, the general insurer may accept premium payments from a client in respect of the life component of the CCI policy to be transferred to the relevant provider. We believe that item 32 should specially exclude an arrangement where a general insurer intermediates between the client and life insurer in respect of the life insurance component of a CCI policy.

- **Item 33:** See Item 32.

- **Item 40:** It is unclear whether this particular item applies to an insurer's agent. It is IAG's view that this particular item should not apply to an insurer's agent.

- **Item 41:** See Item 40.

- **Item 42:** As an AFSL holder, a general insurer could be authorised to provide financial product advice in relation to life products, limited to life risk insurance products and any products issued by a registered life insurance company relating to CCI products. Based on the AFSL authorisations, the general insurer would be deemed to be providing a designated service if it provides personal financial product advice. IAG submits that this is an unintended consequence of the Draft Exposure Bill. We believe that, due to the nature of the product and its use, CCI should be exempt from the definition of a 'life policy' for the purposes of the Bill.

- **Item 43:** See Item 42.

- **Item 44:** IAG seeks clarification whether it is the Government's intention to capture employer funded superannuation contributions under the *Superannuation Guarantee (Administration) Act 1992*. Given these are statutory contributions that cannot be withdrawn prior to retirement there is an extremely low risk of money laundering.

- **Items 45-47:** See item 44

- **Item 54:** We note that a definition for "custodial or depository service" is absent from the Bill. However, we would expect the definition to be consistent with Ch. 7 *Corporations Act 2001*. Again, IAG has concerns in relation to CCI and custodial or depository services, in that a general insurance provider may hold a life insurance policy (provided by a non-related entity) on trust for its customers. IAG believes that this is an unintended consequence and requires further investigation.

Monetary Limit

The *Financial Transaction Reporting Act 1988* (**FTRA**) defines a general insurer as a "cash dealer". IAG is therefore required to report cash transactions of greater than $10,000 to AUSTRAC.

Aside from the designated services specified at Items 21 and 22, there are no monetary thresholds that apply in determining whether an activity or transaction is a designated service. This means that even if the service relates to a transaction whose value is low, the fact that the service is provided will be sufficient for it to constitute a "designated service".

IAG is concerned that whilst a transaction could be regarded as non-material under the current legislative regime (ie less than $10,000 in value), no such provision is available in the Bill. We believe that the lack of a minimum monetary value will be detrimental for designated service providers and cash dealers who become designated service providers. Designated service providers will be required to re-align (from the current regulatory regime) and re-focus risk management and compliance strategies to analyse and monitor transactions below the monetary threshold currently defined in the FTRA.

Carrying on business

Throughout the Bill, reference is made to specific activities being carried on in the "…course of carrying on a business" as "designated services". We hold the view that the definition of "business" is unqualified, thereby applying to any type of business, and therefore question its relevance to, for example, a business providing financial services or banking. This is inconsistent with the FATF recommendations. The recommendations are expressed to impose obligations on "financial institutions" (and in certain circumstances on "non-financial businesses and professions"). "Financial institution" under the FATF recommendations is defined as "any person or entity who conducts **as a business** one or more" of the prescribed activities. The Draft Exposure Bill ignores this important qualification.

However, of greater concern to IAG is that the definition of "business" in the Draft Exposure Bill goes beyond the FATF recommendations and extends to one-off and occasional activity. IAG believes there is some scope for the ambit of the definition of "business" to be reduced without making it inconsistent with the FATF recommendations.

Risk Based Approach

We welcome a risk-based approach outlined in the Bill, but question the prescriptive element of KYC / CDD within this approach. There should be a requirement for entities to adopt a risk-based approach to CDD in order to assess the money laundering risk of each business relationship.

A risk-based approach starts from the assumption that most customers are not money launderers and recognises that firms should be able to identify where financial crime risks reside in their own business. This approach allows firms to focus their efforts where they are most needed and where they will have the most impact. Factors to be considered can include issues such as jurisdiction, customer type, class of business and distribution channel. Taking a proportionate, risk based approach to anti-money laundering can have significant benefits to businesses, being cost effective (identifying where limited resources need to be deployed) enabling firms to identify and focus on high risk areas. A good example of a risk based approach is found in the way APRA have developed the Risk Management Standard for General Insurers; **Prudential Standard GPS 220 – Risk Management**, which has high level principles and identifies specific areas requiring risk management without prescribing the method of managing risk.

Related Entities / Application to In-House Services

The Draft Exposure Bill provides no qualification or exception where a designated service is provided to a related body corporate. We would expect that the rules would provide guidance in relation to the low risk nature of the provision of intra-group designated services, coupled with the ability for the provider of the designated service to succinctly recognise the client.

Further, the Draft Exposure Bill does not draw a distinction between professionals who provide designated services in the course of carrying on their own business and whose who perform a designated service in the capacity of an employee of a person or entity that carries on a business. IAG believes that this issue should be addressed.

Consultation Period

IAG notes that the Attorney-General's Department requires comment on the Bill by 13 April 2006. As the Bill is one that could be considered 'principles based', significant detail exists in the regulations (to be provided by the Attorney-General's Department) and the rules (to be provided by AUSTRAC). It would not be prudent for IAG to make comment on issues, such as politically exposed persons (PEPs), where the Bill refers to the regulations for definition. IAG therefore believes that it is appropriate for the Attorney-General's Department to consider a second round of consultation, where the Bill, regulations and rules can be considered as one complete package.

This belief is further compounded, by IAG's expertise in analysing and implementing the requirements of Ch 7, *Corporations Act 2001*. This period demonstrated the desirability of industry having access to all documents concerning the operation of the Bill, thereby allowing industry to consider a holistic response to the reform package. Training, intra-group relationships and compliance arrangements can be simultaneously assessed and gaps identified, against the requirements of the reform package.

IAG therefore believes that it would be prudent for the Attorney-General's Department to re-assess the consultation period, based on industry having access to the full suite of initiatives contained in the reform package.

Transition Arrangements

From an operational perspective, IAG does not believe that it is appropriate for the Bill to come into effect "as soon as practicable after the date of commencement of the Bill".

Our concerns are based on our experiences in implementing Ch. 7 *Corporations Act 2001*, the current status of the rules and our view that the reform package needs to be analysed in a holistic manner. This situation is compounded by the fact that organisations currently defined as "cash dealers" under the FTRA will need to undertake systems and training reviews, then implement any changes to systems and procedures as deemed necessary. Designated service providers, who are not "cash dealers" under the FTRA will be required to establish systems and procedures from the ground up.