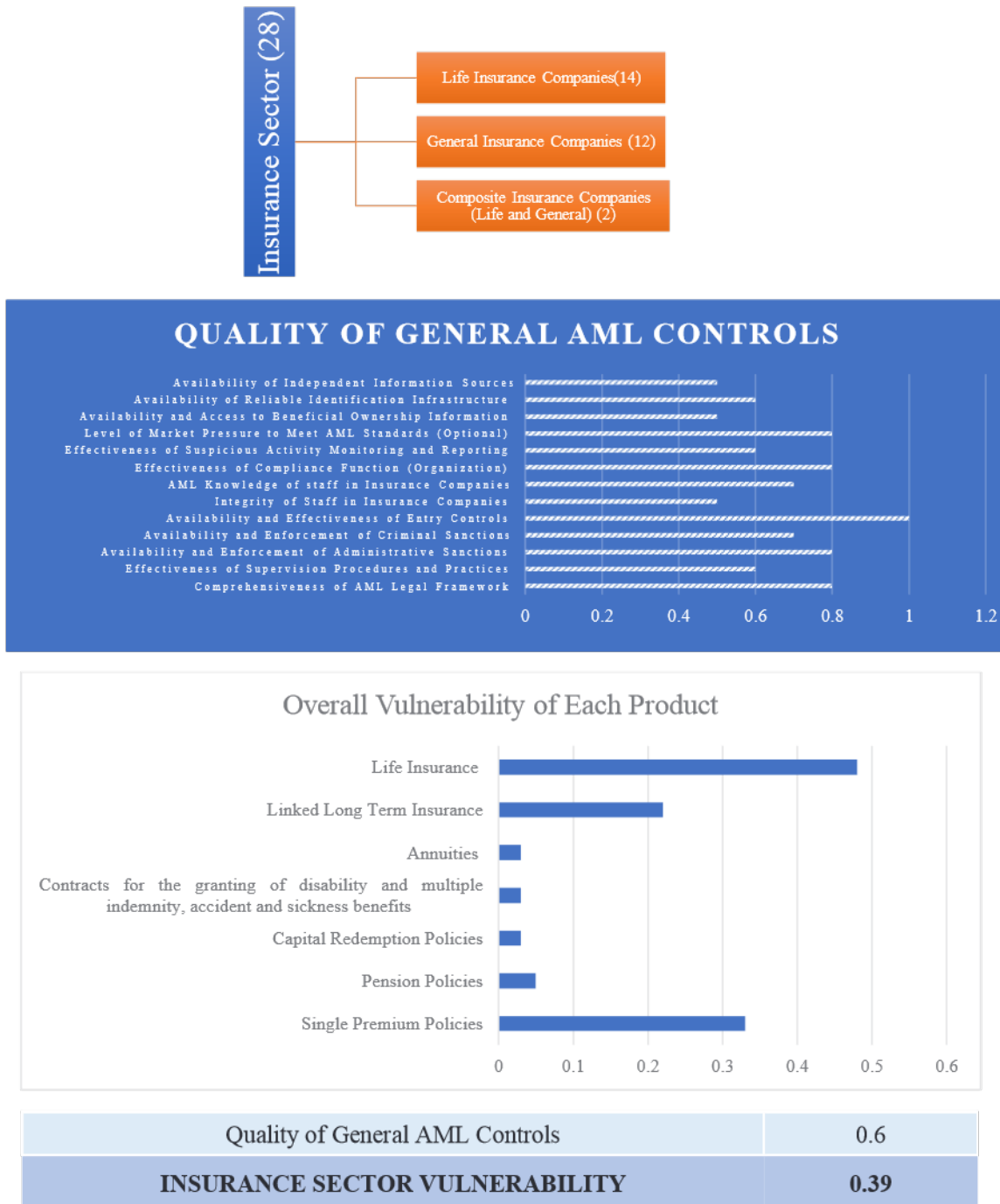


5. INSURANCE SECTOR VULNERABILITY ASSESSMENT

Figure 1: Highlights of the Insurance Sector Vulnerability Assessment



5.1 Introduction

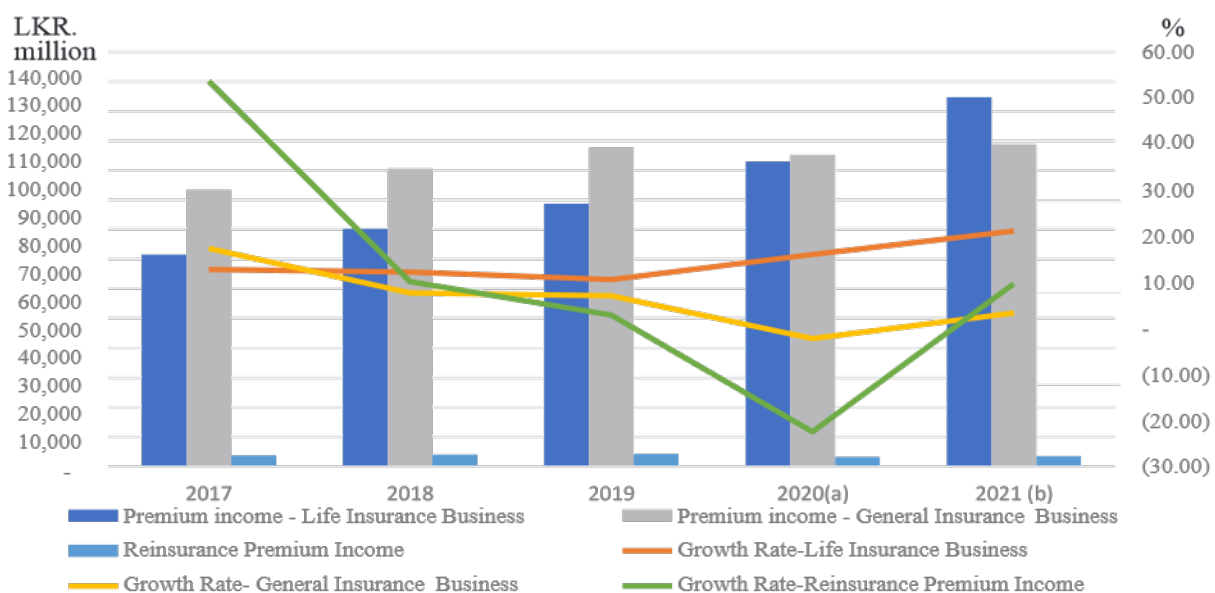
IRCSL is responsible for the development, supervision and regulation of the insurance industry in Sri Lanka under Regulation of Insurance Industry Act, No. 43 of 2000, (RII Act) as amended by Act, No. 23 of 2017. At end of 2022, the insurance industry of Sri Lanka consisted of 28 insurance companies with 14 life insurance companies, 12 general insurance companies and 2 composite insurers carrying on both life insurance business and general insurance business. The National Insurance Trust Fund also comes under the purview of IRCSL. By the end of 2022, 77 insurance brokering companies were operating in the market.

The total asset portfolio of the insurance industry amounted to Rs. 888,377 million in 2021 which is only 3.4 per cent of the total assets of major financial sectors of Sri Lanka.

Total Gross Written Premium (GWP) generated by the insurance industry amounted to Rs. 257,580 million in 2022 and demonstrated a growth rate of 10 per cent compared to 2021. Life insurance business recorded GWP of Rs. 135,367 million and industry grew by 9 per cent. GWP of the general insurance industry recorded an increase of 12 per cent with a premium income of Rs. 122,212 million during 2022 against the premium income of Rs. 108,760 million recorded in 2021.

Insurance penetration which is expressed by the GWP as a percentage of GDP stood at 1.39 during 2021. The penetration of life insurance business and general insurance business were 0.74 and 0.65 respectively. Insurance density, which is stated as the ratio of premium to total population has increased from Rs. 9,502 in 2020 to Rs. 10,539 in 2021.

Figure 2: Premium Income and Growth Rate of the Insurance Industry



Source: Statistical Review 2021, Insurance Regulatory Commission of Sri Lanka

IRCSL implemented the Risk-Based Capital (RBC) regime in 2015. Insurers started to fully adopt the regime in 2016 and must maintain a minimum RBC ratio. The regulator also mandates the compulsory segregation of life insurance and general insurance businesses and for all insurers to list on the local stock exchange to improve transparency, except those whose parent companies are listed on a recognized stock exchange. However, few insurers are yet to fully comply with this regulation.

For the assessment of insurance sector's vulnerability to money laundering, only life insurance sector/products were considered due to the close to non-existent exposure to ML/TF risk posed by general insurance products.

5.2 Methodology used for Information Collection

A questionnaire was used to collect information from all insurance companies. Accordingly, all insurance companies provided the requested information and information was collated by the IRCSL for the assessment.

5.3 Overall Sector Assessment

The following product categories have been considered for AML control variables and inherent vulnerability variables:

- Life Insurance Products
- Linked Long Term Insurance
- Annuities
- Contracts for the Granting of Disability and Multiple Indemnity, Accident and Sickness Benefits
- Capital Redemption Policies
- Pension Policies
- Single Premium Products

The overall ML vulnerability for the insurance sector was assessed as **Medium Low** with a score of 0.39. NRA - 2014 considered both life products and non-life insurance products, however, only life insurance products were considered for the NRA 2021/22.

5.3.1 Quality of General Anti-Money Laundering Controls

5.3.1.1 Comprehensiveness of Anti-Money Laundering Legal Framework

Insurers (Customer Due Diligence) Rules, No. 1 of 2019¹ - Extraordinary Gazette No. 2123/14, May 13 of 2019 was issued for the insurance sector covering ML and TF risk management which includes controls and policies, compliance, audit and training, foreign branches and subsidiaries, using new technologies, CDD including CDD in general, timing of verification, enhanced CDD, on-going CDD, existing customers, CDD for legal persons and legal arrangements, Non-Governmental Organisations (NGOs), NPOs or charities, customers from high risk countries, PEPs, reliance on third-parties, record keeping, customer screening, etc. Further, FTRA has

¹ Under the powers given by the FTRA, the FIU initially issued "KYC – CDD Rules for insurance industry" during 2008/09. In 2019, it was repealed and Insurers (Customer Due Diligence) Rules, No. 1 of 2019 - Extraordinary Gazette No. 2123/14, was issued on May 13 of 2019.

provisions regarding CDD, record keeping, STRs, tipping-off and confidentiality, etc. Considering the above areas covered by CDD Rules and FTRA and additional provisions of PMLA and CSTFA, comprehensiveness of AML legal framework was rated very high.

5.3.1.2 Effectiveness of Supervision Procedures and Practices

FIU provides resource/technical assistance to conduct joint supervision for the insurance sector as per the annual supervision plans prepared by IRCSL. Although the risk of ML/TF of the sector is very minimal compared with other financial sectors, the supervision process for the insurance industry needs to be much more improved with more onsite inspections.

Table 1: Summary of Joint Supervisions and Prudential Supervisions on Insurance Companies with/conducted by Insurance Regulatory Commission of Sri Lanka

	2014	2015	2016	2017	2018	2019	2020	2021	2022
Joint Supervisions with IRCSL	Joint Supervision started from 2018				01	03	02 (01 Remote)	03	03
Prudential Supervision by IRCSL	07	02	05	03	03	03	01 (Remote)	02 (Remote)	01
	Compliance with AML guidelines were also verified when conducting onsite inspections.								

Sources: Insurance Regulatory Commission of Sri Lanka
Financial Intelligence Unit – Sri Lanka

Therefore, effectiveness of supervision procedures rated medium high.

5.3.1.3 Availability and Enforcement of Administrative Sanctions

FTRA provides for administrative sanctions including imposing penalties and suspension of businesses and IRCSL is empowered to issue directions, warnings letters to insurance companies, suspension of license, cancellation of license, etc., in the event insurers violate the provisions of RII Act, rules, determinations, and circulars.

Table 2: Suspensions and Warnings issued by Insurance Regulatory Commission of Sri Lanka

2022	<ul style="list-style-type: none"> No suspension was imposed by IRCSL during 2020. However, the suspension imposed on a takaful insurance company, in year 2009, continued during 2022. The Commission decided to warn the Principal Officer of an insurer for violating Direction #18 by writing back unrepresented claim cheques in the year 2019. In terms of Direction # 18, dated 22nd February 2019, all insurers carrying on long-term insurance business are prohibited from transferring unclaimed benefits to shareholders, with effect from the financial year ended 31st December 2018. The Commission decided to warn the Chief Financial Officer of an insurer for neglecting his duties as the Chief Financial Officer by allowing/approving payments of dividend which was prohibited by the Commission.
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2021	<ul style="list-style-type: none"> The suspension imposed on a takaful insurance company in year 2009 continued throughout the year 2021. Although the said insurance company has settled all claims, other than few claims which are the subject matter of litigation, the claim settlement process could not be concluded in view of such court cases.
2020	<ul style="list-style-type: none"> No suspension was imposed by IRCSL during 2020. However, the suspension imposed on a takaful insurance company, in year 2009, continued during 2020.
2019	<ul style="list-style-type: none"> After considering the deteriorating financial status of an insurance company, where its financial viability was in serious doubt suspended its registration to carry on both Long Term and General Insurance Businesses, from 20th July 2017 till 2nd April 2019. An insurer continued with a reinsurer with ratings below IRCSL prescribed ratings, therefore, IRCSL issued a Warning to the said insurer for non-compliance with the aforesaid Reinsurance Terms and Conditions. An insurer which has been already directed to refrain from obtaining facilities from Banks without the prior written approval of IRCSL in 2012 has carried out two transactions with regard to obtain loan facilities without IRCSL's approvals. Therefore, IRCSL issued a warning to the company for the above two violations.
2018	<ul style="list-style-type: none"> IRCSL has issued a Direction, in year 2015, to an insurer prohibiting them from obtaining services from any related party without obtaining prior written approval from the Commission. However, as the company has obtained such services without first seeking approval of the Commission, a warning was issued to all Directors and the Principal Officer of the company.
2017	<ul style="list-style-type: none"> IRCSL has issued a Direction to an insurer requiring them to furnish Monthly Returns with effect from August 2017 within 21 days from the end of each month. However, the company has continued to not submit the same and IRCSL warned the company for violating the provisions of the Act, particularly the direction issued.
2016	<ul style="list-style-type: none"> An insurance company was suspended from 25th July 2016 to 15th August 2016 since the company failed to demonstrate compliance with the required solvency margin amount. The Insurance Board of Sri Lanka (IBSL)* has suspended another insurance company, from 4th October 2016 to 25th October 2016, for failing to fulfill the requirements set out by IBSL and to demonstrate compliance with Solvency Margin (Risk Based Capital) Rules, segregation requirements etc. <p><i>* The Insurance Board of Sri Lanka (IBSL) changed its name as the IRCSL from 2017 onwards.</i></p> <ul style="list-style-type: none"> IBSL has warned the members of IBSL of an insurance company for providing false and inaccurate information in their quarterly returns submitted to IBSL. In terms of Section 57 of the Act, IBSL has issued a Direction to an insurer in 2015, requiring them to furnish Monthly Returns within a period of 15 days from the end of each month. However, the company has failed to submit same for the month of April 2016 and IBSL has warned the company for violating the provisions of the Act, particularly the direction issued previously.

2015	<ul style="list-style-type: none"> • No suspension was imposed by IBSL during the year. However, the suspension imposed on a takaful insurance company, in year 2009, continued during 2015. • A warning has been issued to an insurance company for entering into a facultative reinsurance arrangement with a reinsurer violating the compulsory cession requirement specified in Section 31 (1A) of the Act. • IBSL has issued several Directions to an insurer with regard to winding up.
2014	<ul style="list-style-type: none"> • No suspension was imposed by IBSL during the year. However, the suspension imposed on a takaful insurance company, in year 2009, continued during 2014. • Directions were issued by IBSL to two insurance companies in terms of Section 57 of the Act, for violating Solvency Margin Rules and these companies were required to furnish returns monthly in addition to the Quarterly Returns. • IBSL warned an insurance company for violating a previous Direction issued by the Board by incorporating a subsidiary company without the prior written approval of IBSL. IBSL once again warned the same insurance company for violating two Directions issued previously, one such warning is for incorporating a subsidiary company without the prior written approval of the Board and the second warning is for issuing insurance policies to persons within the group of companies of the insurer without having received the full premium as at the commencement date of cover.

Source: Annual Reports 2014-2021, Insurance Regulatory Commission of Sri Lanka

Therefore, availability and enforcement of administrative sanctions was rated very high.

5.3.1.4 Availability and Enforcement of Criminal Sanctions

Availability and enforcement of criminal sanctions was rated medium high mainly due to the provisions available in the PMLA, CSTFA and insurance legal framework for effective criminal sanctions including imprisonment and penalties. But no criminal sanctions have been taken to date.

5.3.1.5 Availability and Effectiveness of Entry Controls

A company wishing to conduct insurance business in Sri Lanka is required to obtain a license from IRCSL prior to carrying on business. The RII Act and rules have set out criteria for registration of insurers.

Further, the applicant company has to submit shareholder details to IRCSL, and any further changes made to its shareholding (even after granting license) shall also be informed to IRCSL.

Table 3: Summary of New Registrations of Insurance Companies and Brokers

	2014	2015	2016	2017	2018	2019	2020	2021	2022
New Registration of Insurance Companies Applications	12	4	-	-	-	-	1	-	1
New License of Insurance Companies Granted	8	3	-	-	-	-	-	-	1
Registration of New Insurance Brokering Companies	-	1	5	9	4	4	10	10	7
Registration of New Insurance Brokering Companies Granted	-	1	3	5	4	4	3	10	7

Source: Annual Reports 2014-2021, Insurance Regulatory Commission of Sri Lanka

Therefore, availability and effectiveness of entry controls was rated medium high as the provisions of RII Act and other rules highly control the entry to the insurance sector².

5.3.1.6 Integrity of Staff in Insurance Companies

Even though IRCSL will peruse the details provided by directors and key management personnel such as Principal Officer and Specified Officer to ascertain whether they are fit and suitable to discharge their duties, all insurance companies do not carry out a vetting process for all staff when recruiting. But insurance companies carry out disciplinary actions on any staff members involved in fraud or policy breaches in line with their internal policies. During 2021, IRCSL has revised a Direction directing persons registered under the RII Act (insurers, brokers and loss adjusters) to refrain from employing persons, in any capacity of employment, whose services have been terminated on the grounds of financial misappropriation or fraud. However, in the event of termination of a person is carried out by an insurer, broker, loss adjuster, such persons are required to follow due process, especially follow the principles of Natural Justice prior to such decision to terminate is taken.

² A person who wishes to carry on insurance business in Sri Lanka is required to obtain a license from IRCSL prior to carrying on business. RII Act and rules have set out criteria for registration of insurers. Further, the applicant company has to submit shareholder details to IRCSL, and any further changes made to its shareholding (even after granting license) shall also be informed to IRCSL. IRCSL is empowered to issue directions, warnings to insurance companies, suspension of license, cancellation of license etc. in the event insurers violate the provisions of the RII Act, rules, determinations and circulars.

Table 4: List of Actions Regarding Key Management Personnel by Insurance Regulatory Commission of Sri Lanka

2022	-
2021	<p>The Commission after having examined show cause letters issued to an insurer was of the firm view that the said insurer has failed to satisfactorily justify/reason as to why the Chief Executive Officer (CEO) of the said insurer should not be removed from his prevailing position based on the allegations against him, in terms of Section 57 of the RII Act. In view of the above, the Commission directed the insurer to immediately remove the said CEO from the said position.</p> <p>In a similar situation, the Commission has directed another insurer in terms of Section 57 of the RII Act to remove its Specified Officer from the said post with immediate effect as he had been acting without due care, neglecting his statutory role in terms of Sections 94 and 32 of the RII Act while functioning as the Principal Officer/Specified Officer</p>
2020	-
2019	IRCSL observed that an insurer has been conducting its affairs in a manner that is detrimental to the national interest and prejudicial to the interests of its policyholders, IRCSL issued Directions to the insurer under Section 57 of the Act, out of which one Direction was issued in respect of removal of its Principal Officer and the Chief Financial Officer.

Source: Annual Reports 2014-2021, Insurance Regulatory Commission of Sri Lanka

Also, insurance companies regularly update a list of “black-listed” insurance agents maintained at Insurance Association of Sri Lanka for which all insurers have access.

Considering above factors, integrity of staff in insurance companies was rated medium high.

5.3.1.7 Anti-Money Laundering Knowledge of Staff in Insurance Companies

Majority of insurance companies have developed and conducted training programmes covering AML and CFT laws, policies, procedures. The training material is available to the staff to refer when carrying out their work. In addition, FIU regularly conducts training and awareness programmes for the financial sector. Therefore, AML knowledge of staff in insurance companies was rated medium high.

5.3.1.8 Effectiveness of Compliance Function (Organization)

All insurance companies have a documented internal compliance policy which has considered the levels of risks such as volume, nature of products, client base, clients’ profiles, cross border transactions under the CDD Rules. Further, all insurance companies have appointed a senior management level officer as the AML/CFT compliance officer and are provided competent supporting staff and all insurance companies are required by the regulator to conduct internal and external audits. In addition to the above, compliance policy of insurance companies has provisions for actions on their staff for breaching the compliance policy. Therefore, effectiveness of compliance function (organisation) was rated very high.

5.3.1.9 Effectiveness of Suspicious Activity Monitoring and Reporting

Compared with other financial institutions, STRs reporting by insurance companies are minimal.

Table 5: Suspicious Transaction Reports submitted by the Insurance Sector

	2018	2019	2020	2021	2022
No. of STRs reported by Insurance Sector	-	11	11	27	3

Source: Financial Intelligence Unit - Sri Lanka

The importance of raising STRs is continuously communicated to the insurance companies through awareness and training programmes. Therefore effectiveness of suspicious activity monitoring and reporting were rated medium.

5.3.1.10 Level of Market Pressure to Meet Anti-Money Laundering Standards

Expectations of foreign reinsurers for insurance companies to meet international AML standards and the importance of an insurance company's reputation in a sector which has a low penetration have prompted insurance companies to meet AML standards in the market. Therefore, level of market pressure to meet AML standards were rated very high.

5.4 Product Inherent Vulnerability

For the assessment of inherent vulnerability, WG categorized life insurance sector's products in to seven categories, namely, life insurance (individual & group), linked long term insurance, annuities, contracts for the granting of disability and multiple indemnity, accident and sickness benefits, capital redemption policies, pension policies, single premium products and used seven inherent variables³ to assess and compare product vulnerability.

³ Inherent vulnerability factors include total value/size of the product, use of agents, client base profile of the product, availability of investment type policy, level of cash activity, availability of cross-border use of the product, other vulnerable factors of the product.

Table 6: Summary of Inherent Variable Factors for each Product

	Life Insurance	Linked Long Term Insurance	Annuities	Contracts for the granting of disability	Capital Redemption Policies	Pension Policies	Single Premium Policies
Size of the sector/industry	High	Low					Medium low
Use of Agents	High	Low				Medium low	Low
Percentage of customers who pose higher risk	Low risk	Very low risk					Medium risk
Availability of investment type Policy	Available and prominent	Available	Not available				Available
High cash intensive product/services	Medium low						
Frequency or % of international transactions	Low						
Anonymous/Omnibus use of the product	Not available						
Existence of ML typologies on the abuse of the product	Exist but limited	Does not exist					Exist but limited
Use of the product in insurance fraud or tax evasion schemes	Does not exist						
Difficulty in tracing the transaction records of the product	Easy to trace						
Non face-to-face use of the product	Not available						
Others	Does not exist						

Life insurance product category is the largest contributor of the life insurance sector. Even though the statistics analyzed during the assessment indicated high level cash intensiveness, majority of the life insurance products are regular premium policies with low exposure to PEPs, non-residents and high-risk jurisdictions. Therefore, the product inherent vulnerability of life insurance products (individual and group) was rated medium. Even though single premium products have higher susceptibility to be used for money laundering, due to the low level of cash intensiveness and minimal number of transactions with PEPs, non-residents and trusts, single premium policies' product inherent vulnerability was rated medium low. Product inherent vulnerability of linked long-term insurance products was rated medium low as there were no international transactions, minimal level of cash intensiveness and minimal number of transactions with PEPs, non-residents and high-risk jurisdictions. Product inherent vulnerability of other product categories: annuities, contracts for the granting of disability and multiple indemnity, accident and sickness benefits, capital redemption policies and pension policies, were rated low mainly due to low volumes compared with the other products, low level of cash intensiveness and minimal amount of transactions with PEPs, high net-worth customers and high-risk jurisdictions.

Table 7: Summary of Product Inherent Vulnerability for each Product

Product	Vulnerability of each product
Life Insurance Products (Individual and Group)	Medium
Linked Long Term Insurance	Medium Low
Annuities	Low
Contracts for the granting of disability and multiple indemnity, accident and sickness benefits	Low
Capital Redemption Policies	Low
Pension Policies	Low
Single Premium Products	Medium Low

5.5 Priority Areas Identified from the Assessment

- Although the risk of ML/TF of the insurance sector is minimal, the effectiveness of supervision procedures and practices need to be much more improved with more onsite supervisions conducted by the FIU and the IRCSL.
- Improve the effectiveness of suspicious activity monitoring and reporting by increasing the number of training and awareness programmes to emphasize the importance of raising STRs and to provide typologies to identify the areas where the insurance sector could be used by money launderers.
- Increase the number of training and awareness programmes to, improve the AML knowledge of insurance staff, identify the areas where the insurance sector could be used by money launderers, conduct KYC / CDD process properly.
- A vetting process be introduced for the staff of insurance sector, not limiting to key management personnel, to enhance the integrity of the staff of insurance companies and to develop a mechanism to ensure staff members as secure from corruption by criminals.