Anti Money Laundering/ Combating Financing of Terrorism Framework

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<u>HDFC Life Insurance Company Limited Anti Money Laundering (AML) Framework</u>

1. Background and Objective

Background:

The Prevention of Money Laundering Act, 2002 brought into force with effect from 1st July 2005, is applicable to all the financial institutions, which include insurance institutions. The application of AML measures to non-depository financial institutions generally, and to the insurance companies in particular, has also been emphasized by international regulatory agencies as a key element in combating money laundering. Establishment of AML program by financial institutions is one of the central recommendations of the Financial Action Task Force (FATF) and also forms part of the Insurance Core Principles of the International Association of Insurance Supervisors (IAIS). Accordingly, the Insurance Regulatory and Development Authority of India (IRDAI) has issued regulatory guidelines to the Insurers as part of an AML Program for the insurance sector.

Responsibility of HDFC Life Insurance Company Limited:

HDFC Life Insurance Company Ltd. (hereafter referred to as the “HDFC Life” or “Company”) is fully committed to comply globally with all applicable laws designed to combat money laundering and any activity which facilitates the funding of terrorist or criminal activities. HDFC Life would meet the extant regulatory requirements and the Frame work would be amended from time to time as may be required by the Authority and Compliance with Financial Action Task Force requirements.

Objective:

The key objectives of this document are:
1. To lay down the detailed AML Framework of HDFC Life.
2. To ensure that none of its products are vulnerable to Money Laundering and also to ensure that company is not used as a conduit for Money laundering.
3. To ensure compliance with the AML laws and regulations in force from time to time.
4. To protect company’s reputation.
5. To assist law enforcement agencies in their effort to investigate and track money launderers.
6. To lay down AML compliance norms for the employees of the Company.

2. Money Laundering – Definition

2.1 Money Laundering is moving illegally acquired cash through financial systems so that it appears to be legally acquired.

2.2 There are three common stages of money laundering as detailed below which are resorted to by the launderers and insurance institutions may unwittingly be exposed to a potential criminal activity while undertaking normal business transactions:

1. **Placement** - the physical disposal of cash proceeds derived from illegal activity;
2. **Layering** - separating illicit proceeds from their source by creating complex layers of financial transactions designed to disguise the source of money, subvert the audit trail and provide anonymity; and
3. **Integration** - creating the impression of apparent legitimacy to criminally derived wealth.

2.3 If the layering process has succeeded, integration schemes place the laundered proceeds back into the economy in such a way that they re-enter the financial system appearing to be normal business funds.

Section 3 of PMLA, describes the offence of Money Laundering. Section 3 reads as under:
"*Whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money-laundering*."

3. Money Laundering Risks

The Company is aware that it is exposed to several risks if an appropriate AML framework is not established, which are detailed as under:

1. **Reputation Risk** - Risk of loss due to severe impact on Company's business. This requires maintaining the confidence of authority, customers, creditors and the general marketplace.
2. **Compliance Risk** - Risk of loss due to failure of compliance with key Regulations governing the company's operations.
3. **Operations Risk** - Risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.
4. **Legal Risk** - Risk of loss due to any of the above risks or combination thereof resulting into the failure to comply with Law and having a negative legal impact on the Company. The specific types of negative legal impacts could arise by way of fines, confiscation of illegal proceeds, and suspension/termination of licenses by the regulators, criminal liability, etc.
5. **Financial Risk** - Risk of loss due to any of the above risks or combination thereof resulting into negative financial impact on the Company.

4. AML/CFT Governance Framework structure:

As required by IRDAI guidelines, company's AML Framework is broadly divided into the following main components:

1. AML/KYC Standards;
2. Appointment of Designated Director and Principal Compliance Officer;
3. Recruitment and training of employees/agents;
4. Internal Control/Audit;

4.1 AML/KYC Standards:

4.1.a Basic Due Diligence [Know Your Customer (KYC)]:

Keeping in view the specific requirements of the guidelines issued by IRDAI and other regulatory bodies and considering the potential threat of usage of financial services by a money launderer, company shall make reasonable efforts to determine the true identity of all customers by doing proper Customer Due Diligence (CDD). Effective procedures should be put in place to obtain requisite details for proper identification of new customers.

1. Agents / Financial Consultant's (FCs) shall be required to provide information to indicate any behavioral aspects of a customer that are found to be suspicious at the time of their interaction.

2. Special attention will be given to all complex, unusually large transactions and all unusual patterns which have no apparent economic or visible lawful purpose.

3. Company will not enter into a contract with a customer whose identity matches with any person with known criminal background or with banned entities and those reported to have links with terrorists or terrorist organizations. Customer's name screening will be done daily against the negative list. In case any matching records are identified, it will be reported to the relevant authority.

4. In case of receipt of order to freeze / unfreeze account is received under section 51A of the UAPA, it will be implemented without prior notice to the designated individuals / entities.

5. Measures will be taken to identify beneficial ownership in case of non-individual customers.

4.1.b When should KYC be done?

1. **New Customers:**

   a) In case of new contracts, KYC / CDD should be done before entering into any contract pertaining to insurance with new customer.

2. **Ongoing basis**:

   KYC should also be carried out at the claim payout stage and at times when additional top up remittances are inconsistent with the customer known profile. Any change which is inconsistent with the normal and expected activity of the customer, further KYC processes and / or action as considered necessary.

4.1.c Risk Profile of the Customer

Entity Risk Assessment:

As a large Life Insurance Company, the number of policies issued, and financial transactions conducted by the customers are of a very high magnitude. Regulations require the Company to monitor all policy issuances and transactions there under for any suspected incident of money laundering. However, considering the spirit as well as the requirements under the regulations, the monitoring efforts are directed more towards the customers and transactions with higher risk of money laundering, being the Risked Based Approach (RBA) for monitoring and controls. Thus, our focus would be on higher risk areas e.g. risk arising from payments instruments viz. Demand Draft vs Cheque, Online vs Offline etc., and monitoring the same for suspected money laundering.

Adopting a RBA implies the adoption of a risk management process for dealing with Money Laundering (ML) / Terrorist Financing (TF), keeping in mind the magnitude of risk involved.

A risk analysis would be performed to determine where the ML/TF risks are the greatest based on customers, products and services, including delivery channels, and geographical locations. They can change over time, depending on how circumstances develop, and how threats evolve, and our controls would also change accordingly. This process thus encompasses recognizing the existence of the risk(s), undertaking an assessment of the risk(s) and developing strategies to manage and mitigate the identified ML risks.

In the context of the very large base of insurance customers and the significant differences in the extent of risk posed by them, HDFCL shall classify the customer into high risk and low risk, based on customer category / nature / occupation / geography / sourcing channel / products features / premium payment modes / review of sanctions lists for money laundering or terrorism, as follows:

4.1.d Enhanced Due Diligence:

It is imperative to ensure that the insurance being purchased is reasonable. Accordingly, customer's source of funds, his estimated net worth etc., shall be appropriately documented and company obtains income proofs and details of sources of funds for all policies as specified by the Company from time to time.

Premium payments are received or can be received through various modes, including, Demand Drafts (DD), cheques, online transfers, etc. However, the Company will have power to prescribe rules / limits etc. for any particular payment mode, or to disallow any payment mode(s) for any one or more channel. The cash acceptance limit / rules etc. shall be such, as may be decided from time to time, keeping in view business requirements and regulatory provisions.
PAN and KYC documents of the payor to be obtained in case of third party payment (other than proposer).

Suspicious Transactions (including Suspicious Cash Transactions):

The AML program envisages submission of Suspicious Transaction Reports (STR) / Cash Transactions Reports (CTR) / Counterfeit Currency Report (CCR) / Non Profitable Organisation Transactions Report (NTR) to the Financial Intelligence Unit-India (FIU-IND) set up by the Government of India to track possible money laundering attempts and for further investigation and action.

Prohibition from "Tipping off"

Employees (permanent and temporary) are prohibited (should maintain strict confidentiality) from disclosing the fact that a Suspicious Transactions Report or related information of a policyholder / prospect is being reported or provided to the FIU-IND.

4.1.eRecord Keeping:

Company will maintain the records (either in electronic or in paper form) of types of transactions mentioned under Rules 3 and 4 of PMLA Rules 2005 and the copies of the Cash / Suspicious Transactions reports submitted to FIU as well as those relating to the verification of identity of customers for a period of 5 years in order to enable company to comply swiftly with information requests from the competent authorities. Such records shall be sufficient to permit reconstruction of individual transactions (including the amounts and types of currency involved (if any) so as to provide, if necessary, evidence for prosecution of criminal activity. Company will retain the records of those contracts, which have been settled by maturity or claim, surrender or cancellation, for a period of at least 5 years after that settlement. Records pertaining to all other transactions, (for which the Company is obliged to maintain records under other applicable Legislations / Regulations / Rules) the Company will retain records as provided in the said Legislations / Regulations / Rules but not less than 5 years from the date of end of the business relationship with the customer.

The Designated Director, Principal Compliance Officer and staff assisting in execution of AML guidelines should have timely access to customer identification data, other KYC information and records.

4.2 Appointment of 'Designated Director' and Principal Compliance Officer:

4.2.a Appointment:

Company will designate 'Designated Director' and 'Principal Compliance Officer' and intimate the names of the 'Designated Director' and 'Principal Compliance Officer' to IRDAI and FIU-IND. Any change in incumbency will be intimated to IRDAI and FIU-IND immediately.

The 'Designated Director' will be Managing Director or a whole-time Director duly authorized by Board of Directors.

The Principal Compliance Officer will be at a senior level and preferably not below the Head-Audit / Compliance / Chief Risk Officer level and should be able to act independently and report to senior management.

4.2.b Responsibilities:

The Designated Director shall:

Ensure overall compliance with the obligations imposed under chapter IV of the Act and the Rules.

The Principal Compliance Officer shall:

1. Implementation of the AML Program effectively, including monitoring compliance by the company's insurance agents with their obligations under the program.
2. Ensure that employees and agents of the company have appropriate resources and are well trained to address questions regarding the application of the program in light of specific facts.
3. Be responsible for regulatory reporting, as prescribed under the IRDAI guidelines, for Cash Transactions, Suspicious Transactions, Counterfeit Currency Notes and Non Profit Organisation details.

4.3 <u>Recruitment and Training of employees/agents</u>:
The selection process of agents shall be monitored. It shall be ensured that if any unfair practice is being reported, then action is taken after due investigation. Company will have adequate screening procedures when hiring employees / agents. Instruction manuals on the procedures for selling insurance products, customer identification, record keeping, acceptance and processing of insurance proposals, issue of insurance policies will be set out.
The concept of AML will be part of in-house training curriculum for agents.

The following training requirements are considered essential based on the class of employees.

1. **Employees**: A general appreciation of the background to money laundering, and the subsequent need for identifying and reporting of any suspicious transactions to the appropriate designated official shall be provided to all new employees who will be dealing with customers or their transactions, irrespective of the level of seniority.

2. **Sales/Advisory staff**: Members of staff who are dealing directly with the public (whether as members of staff or agents) are the first point of contact with potential money launderers and their efforts are therefore vital to the strategy in the fight against money laundering. It is vital that "front-line" staff is made aware of company's AML Framework for dealing with non-regular customers particularly where large transactions are involved, and the need for extra vigilance in these cases.

3. **Ongoing training:** Refresher training at regular intervals shall be provided to ensure that staff does not dilute its approach to AML Implementation. AML training shall cover aspects related to:
   - AML definition, guidelines and requirements
   - Possible risks due to non-compliance with AML
   - Prevention of fraud or suspicious transactions
   - Mandatory documentation for AML

4. **Records of training imparted to agents / staff** in the various categories detailed above shall be maintained.

4.4 <u>Internal Control/Audit</u>:

HDFC Life internal audit / inspection departments shall verify on a regular basis, compliance with policies, procedures and controls relating to money laundering activities. Exception reporting under AML Frame work shall be done to Audit Committee of the Board.

5. Review of AML Framework:
The AML framework shall be reviewed at least annually and changes effected based on experience and regulatory changes shall be incorporated in the same.