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Developments in Anti-Money Laundering Regulations for the Insurance Sector in Switzerland and the EU

Master-Thesis

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Executive Summary

Objective – This thesis aims to show the most recent developments in anti-money laundering legislation for the insurance sector in Switzerland, the European Union (EU) and globally. It highlights what the key developments are and what this could trigger going forward. In addition, the legal basis are examined in more detail with a primarily focus on the impact for the insurance industry. Furthermore, challenges based on the currently ongoing developments in the area of new technologies as well as new means of payments are analyzed.

Research Methodology – In order to explain the theoretical background, an analysis of the corresponding legal texts and an adequate literature research have been carried out. On the basis of the findings obtained and the questions raised, an expert interview has been conducted with the chair of the anti-money laundering working group of the Self-Regulatory Organization of the Swiss Insurance Association using the qualitative method. Thus, this thesis is based on both a theoretical and a practical approach.

Results – The aim of this thesis with the title: "Developments in Anti-Money Laundering Regulations for the Insurance Sector in Switzerland and the European Union" was to shed light on core developments and to highlight the requirements, where changes have the biggest impact. Furthermore, the influence of the changed regulatory framework on the insurance industry has been examined. However, due to the lack of practical experience in some areas, such as the requirement for Swiss insurance companies to monitor money laundering risks globally or the not yet very widespread FinTech/RegTech initiatives, it is not yet possible to draw any conclusions about the impact this may have on the insurance market and its players. The Swiss Insurance Association assumes that some players will delay the widespread use of FinTech/RegTech applications in relation to anti-money laundering prevention in the midterm due to the very outdated underlying core infrastructure and the resulting costs.

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Declaration of authorship and plagiarism

I hereby declare

- that I have written this thesis without any help from others and without the use of documents and aids other than those stated below;
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Zurich, 19. July 2019

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Sven Dobler

Acknowledgement

When I think of the last months, I look back on an extremely instructive, intensive but also interesting time when I wrote my Master Thesis.

The past few months have been marked by intensive research in the field of national and international anti-money laundering legislation and its development over the past few years. I found this time exciting, challenging and exhausting. The familiarization with the topic, the demarcation to other topics, as well as the selection of reliable sources, was connected with enormous workload.

Besides the hard work and perseverance, the work also required the support of colleagues, friends and family. However, I am proud to present the present work in this form and execution, as it is now available to the readership.

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With this in mind, I wish the readers an exciting and thought-provoking read with this work.

Glossary

Enhanced Due Diligence	Additional Due Diligence measures that go beyond what one needs to look at in a standard scenario are usually referred to Enhanced Due Diligence.
Blockchain	A blockchain is a type of distributed ledger in the form of a continuously growing list of records based on blocks, which are linked and secured using cryptographic signatures. Each block typically contains a hash pointer as a link to a previous block, a timestamp and transaction data. Blockchains are inherently resistant to data modification. From a functional perspective, a blockchain can serve as an open, distributed ledger that can record transactions between two parties (accounts) efficiently and in a verifiable and permanent way (Zhu, 2017, p. 1).
FATF	The Financial Action Task Force (FATF) is an inter-governmental body established in 1989 by the Ministers of its Member jurisdictions. The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system.
FIAT Currency	Fiat Currency are coins and banknotes that are designated as legal tender and electronic money, of a country, accepted as a medium of exchange in the issuing country (e.g., CHF / EUR / USD / etc.) (Council Directive 2018/843/EC).
FinTech	Financial Technology (FinTech) is used to describe computer programs and other new technology that seeks to

	improve and automate the delivery and use of financial services.
G7-Summit	The G7-Summit is a meeting of the Heads of State or Government of seven major industrial nations and the President of the Commission and the Council of the European Union. The core G7 members are Canada, France, Germany, Italy, Japan, the United Kingdom and the United States of America.
ICO	ICOs are a digital blockchain-based form of public fundraising for entrepreneurial purposes (FINMA, 2018f).
Panama Papers	The name "Panama Papers" is used to describe the leak of approx. 11.5 million documents belonging to Mossack Fonseca, a Panamanian based law firm. The law firm created offshore shell / anonymous companies for individuals and entities world-wide.
Politically Exposed Person	The term politically exposed person means a natural person (usually including their family members[1], persons known and close associates[2]) who is or who has been entrusted with prominent public functions and includes the

[1] *"[…] (a) the spouse, or a person considered to be equivalent to a spouse, of a politically exposed person; (b) the children and their spouses, or persons considered to be equivalent to a spouse, of a politically exposed person; (c) the parents of a politically exposed person; […]" (Council Directive 2015/849/EC)*

[2] *"[…] (a) natural persons who are known to have joint beneficial ownership of legal entities or legal arrangements, or any other close business relations, with a politically exposed person; (b) natural persons who have sole beneficial ownership of a legal entity or legal arrangement which is known to have been set up for the de facto benefit of a politically exposed person […]" (Council Directive 2015/849/EC)*

	following: (a) heads of State, heads of government, ministers and deputy or assistant ministers; (b) members of parliament or of similar legislative bodies; (c) members of the governing bodies of political parties; (d) members of supreme courts, of constitutional courts or of other high-level judicial bodies, the decisions of which are not subject to further appeal, except in exceptional circumstances; (e) members of courts of auditors or of the boards of central banks; (f) ambassadors, chargés d'affaires and high-ranking officers in the armed forces; (g) members of the administrative, management or supervisory bodies of State-owned enterprises; (h) directors, deputy directors and members of the board or equivalent function of an international organization. No public function referred to in points (a) to (h) shall be understood as covering middle-ranking or more junior officials (Council Directive 2015/849/EC).
RegTech	Regulatory Technology (RegTech) is the management of regulatory processes within the financial industry throughout technology. The main functions include regulatory monitoring, reporting and compliance.
Virtual Currency	Virtual currency is a digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued nor guaranteed by any jurisdiction, and fulfils the above functions only by agreement within the community of users of the virtual currency. Virtual currency is distinguished from fiat currency (a.k.a. “real currency,” “real money,” or “national currency”),

	which is the coin and paper money of a country that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country. It is distinct from e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency. E-money is a digital transfer mechanism for fiat currency i.e., it electronically transfers value that has legal tender status (FATF, 2014).

1 Introduction

In the following sections, the problem definition, the objective and limitations of the research and the methodical approach are described. In addition, a first impression of the current situation in the fight against money laundering will be presented.

1.1 Problem Definition

Governments around the world attach great importance to maintain integrity of the international financial system. Because of constantly changing sort of crime they regularly need to adapt their legislation to combat money laundering and terrorist financing in order to preserve the integrity of financial centers and prevent abuse. Countries usually have diverse legal, administrative and operational frameworks and different financial systems and therefore, cannot all take identical measures to counter these threats (FATF, 2018a, p. 6).

One of the most important steps to ensure an aligned response to the mounting concerns over money laundering at the beginning of the early 1990s was the establishment of the Financial Action Task Force on Money Laundering (FATF[3]) at the G-7 Summit that was held in Paris in 1989. The initial mandate was limited to examine and develop measures to combat the misuse of financial systems by persons laundering drug money (FATF, 2018a, p. 6).

After reviewing the actions, which had already been taken at a national or international level, in April 1990, less than one year after being created, the FATF drawn up the original FATF Forty Recommendations, which were intended to

[3] The Financial Action Task Force (FATF) is an inter-governmental body established in 1989 by the Ministers of its Member jurisdictions. The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system.

provide a comprehensive plan of action needed to fight against money laundering of drug money (FATF, 2018a, p. 6).

To reflect evolving money laundering trends and techniques and to broaden the scope of the FATF Recommendations well beyond drug-money the initial Recommendations were revised in 1996 (FATF, 2018a, p. 6).

Another five years later in October 2001, given the close connection between international terrorism and inter alia money laundering the FATF expanded its mandate to deal with the issue of funding of terrorist acts and terrorist organizations. Therefore, the FATF issued its eight specially developed Recommendations with the objective of ensuring that countries have the legal capacity to prosecute and apply criminal sanctions to persons that finance terrorism. Another important objective was that countries, based on the United Nations International Convention for the Suppression of the Financing of Terrorism (1999[4]), include terrorist financing as predicate offences for money laundering (FATF, 1996, p. 4).

To illustrate how universally recognized as the international standard for anti-money laundering and countering the financing of terrorism (AML/CTF) the FATF Recommendations are and to show the continues success, one need to know that the Recommendations were revised a second time in 2003 and these, together with the Special Recommendations have been endorsed in over 180 countries (FATF, 2018a, p. 6).

In October 2004, the FATF published a ninth Special Recommendations focusing on the fight against terrorist financing but even more important was the complete and thorough review of both standards in 2012, which resulted in the one

[4] The UN Convention had not yet come into force at the time FATF originally issued its Special Recommendations (SR). The UN convention came into force only in April 2003. However, the intent of the FATF has been to reiterate and reinforce the criminalization standard as set forth in the Convention (in particular, Article 2).

set of currently valid 40 FATF Recommendations. The nine Special Recommendations, which were focusing on terrorist financing, have been fully integrated with the measures against money laundering (FATF, 2018b).

Although the FATF Recommendations must be seen as an international standard, which is non-binding, the FATF calls upon all countries to implement effective measures adapted to their particular circumstances to bring their national systems for combating money laundering, terrorist financing and the financing of proliferation into compliance with the FATF Recommendations (FATF, 2018a, p. 6 ff.).

When analyzing new laws and regulations on AML/CTF within Switzerland or the European Union (EU), e.g. with the revision of the Anti-Money Laundering Ordinance FINMA (AMLO-FINMA) (FINMA, 2017) or the Directive (EU) 2015/849 of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, of 20 May 2015 (Council Directive 2015/849/EC) it becomes obvious that all these policy makers want to ensure that their legislative framework is aligned with the standard set by the FATF. The Europeans as well as the Swiss are both, in the respective publication of a new set of regulations, stressing that their regulation is aligned with the FATF standard and reflects the Recommendations properly.

To ensure that this is continuing the FATF is committed to maintain a close and constructive dialogue with the private sector, civil society and other interested parties (FATF, 2018a, p. 8).

It thus seems clear that recent efforts to improve international cooperation have resulted in models that globally harmonize the fight against money laundering and terrorism. The possibilities for criminal organizations to continue to undermine the international financial system unrecognized will thus be further restricted in the near future and the ongoing discussions will lead to even closer cooperation between the various countries and institutions.

The intent of this thesis is to provide to an interested circle of experts an insight into the topic of the subject of combating money laundering, while also paying tribute to the revised AMLO-FINMA and the Fifth Anti-Money Laundering Directive (5th AMLD), and in particular its impact on the insurance industry. Finally, it should also be possible for non-anti money laundering experts to use the explanations given in this thesis to draw conclusions on existing legislation (Switzerland & EU) and future developments and challenges due to new technologies available and used in the market.

1.2 Objective and Limitations of the Research

The purpose of this thesis is to shed light on the nature of anti-money laundering legislation in Switzerland, the EU and globally and to highlight the most central requirements. In addition, the importance of these in relation to the insurance industry will be explained and the most recent developments in anti-money laundering regulations will be taken into account.

In principle, there is no binding global standard for anti-money laundering legislation. However, FATF recommendations, which are universally recognized as the international standard for AML/CFT do exist. Nevertheless, the necessary legal basis must first be created in the respective states that have committed themselves to the introduction of the standard or at least endorsed it.

The consequence of this is that the consideration of a multitude of legal provisions is of indispensable necessity. In the context of the consideration of the legal basis, the focus is on the anti-money laundering legislation in Switzerland and the EU.

Based on the analysis of the relevant legal texts, an adequate literature research and an expert interview, a derivation of the possible significance for the insurance industry under the current legislation and the expected changes to it will be made.

The limited scope of the present thesis presupposes a focus on certain core issues, which is why some topics need to be excluded. The focus of the thesis is clearly on the analysis of the current anti-money laundering legislation, its

development in past few years with a cutoff date by April 30, 2019 and its appreciation especially for Switzerland and the EU with a special focus on the insurance industry. This thesis does not attempt to describe the impact on other types of financial services institutions. Rather, the aim is to develop a comprehensive understanding of the subject matter. If this is already possible at this stage, the challenges posed by emerging technologies and means of payment that are establishing themselves on the market will also be highlighted. The present thesis also tries to describe certain influences due to different political interests.

1.3 Methodical Approach

As a basis for writing this master thesis on the developments in anti-money laundering regulations for the insurance sector in Switzerland and the EU, an in-depth literature research has been conducted. Furthermore, the existing legal texts, declarations of intent etc. have been examined and analyzed in detail. As a third instrument, an expert interview was conducted with an external expert, more precisely the chair of the anti-money laundering working group of the Self-Regulatory Organization of the Swiss Insurance Association (SRO-SIA). The aim of that interview was that this will contribute to the analysis of the topic and answer the question that has been elaborated.
The master's thesis was divided into the following topics:

Structure of the Thesis	
1)	Overview of the current Swiss, EU and global anti-money laundering systems
2)	Developments in the respective systems
3)	Interaction between those frameworks
4)	Challenges and future trends

The first chapters explain the current anti-money laundering systems of Switzerland, the EU and globally. This is followed by a fundamental examination and explanation of the most recent developments in the respective systems and

their legislation. Subsequently, the interaction and future challenges and trends were analyzed. This basic research was carried out exclusively on the basis of a literature research.
Based on the findings and the expert interview, the perception and assessment of the significance of current developments in anti-money laundering legislation for the insurance industry will be derived.

1.3.1 Research Methodology

In order to analyze the research problem, the qualitative method by interview was chosen. In order to understand what the interviewed expert of the SRO-SIA thinks of the most recent developments in the anti-money laundering legislation or to capture the SRO-SIA's view in relation to the potential impact on the insurance industry, the qualitative method is ideally suited. Thus, the connection between certain answers to the present text of the legislations, the current initiatives driven by the FATF or the IIF can be recognized very quickly and an interpretative data analysis can be carried out. Since the data from the interview are not available in numerical form, an attempt is made to obtain a more open data collection in order to optimally incorporate the context (Gläser & Laudel, 2010, p. 92f). Not only is a "why" sought, as it is usual with the quantitative method, but one also wants to understand and get further insights on the interviewee or the SRO-SIA views with regards to specific developments in the area of anti-money laundering regulations for the insurance sector.

2 Switzerland's Anti-Money Laundering System

In the following chapter, one would like to give an overview of the current legislative framework around the AML legislation in Switzerland with a special focus on the insurance sector. In addition, an analysis on the current developments and an outlook on "What is to come" will be provided. The constitutional basis will only be provided on a high level and not very granular.

2.1 Current legislative framework

The current legislative framework which regulates the combating of money laundering and terrorist financing for the insurance industry in Switzerland consists of the following elements:

Title	Scope
Swiss Criminal Code (SCC)	The SCC is a set of laws that regulates the core subject matter of Switzerland's criminal law and specifies punishable conduct as well as the scope of the punishment to be imposed in a given case. In addition, the SCC includes a provision regarding the reporting of the suspicious activity reports for money laundering and terrorist financing to the Money Laundering Reporting Office Switzerland (MROS).
Swiss Anti-Money Laundering Act (AMLA)	According to the AMLA (Anti-Money Laundering Act, Art. 1) the AMLA regulates the combating of money laundering, the combating of terrorist financing and the due diligence required in financial transactions.
FINMA Anti-Money Laundering Ordinance (AMLO-FINMA)	According to the AMLO-FINMA (FINMA Anti-Money Laundering Ordinance, Art. 1 Para. 1)

	the Ordinance specifies how financial intermediaries must implement the obligations to combat money laundering and terrorist financing.
Regulation of the Self-Regulatory Organization of the Swiss Insurance Association (R SRO-SIA)	According to the R SRO-SIA (Regulation of the Self-Regulatory Organization of the Swiss Insurance Association, Art. 1 Para. 1) *"The R SRO-SIA specifies the obligations of insurance undertakings to combat money laundering and terrorist financing, in particular the obligations under the Federal Act on Combating Money Laundering and Terrorist Financing and the Ordinance of the Swiss Financial Market Supervisory Authority on Combating Money Laundering and Terrorist Financing."*

Table 1: Switzerland's Legislative Framework on AML for Insurance Companies

More details will be provided in the following sections of this chapter.

2.1.1 Swiss Criminal Code

Exclusively highlighting the relevant sections on AML the SCC defines in Art. 305bis the combating of money laundering and in Art. 260^{quinquies} paragraph 1, the combating of terrorist financing and the due diligence required in financial transactions. In addition, the SCC includes under Article 305ter paragraph 2 SCC a provision regarding the reporting of the suspicious activity reports for money laundering and terrorist financing to the Money Laundering Reporting Office Switzerland (MROS).

2.1.2 Swiss Anti-Money Laundering Act

As outlined already in section 2.1 of this thesis, the AMLA regulates the combating of money laundering, the combating of terrorist financing as defined in the SCC and the due diligence required in financial transactions.

The AMLA has first been issued in October 1997 and was effective as of 1 April 1998. The latest revision of the AMLA came into effect as of 1 January 2016 and is currently being revised.

2.1.3 FINMA Anti-Money Laundering Ordinance

The AMLO-FINMA specifies how financial intermediaries according to Art. 3 Para. 1 must implement the obligations to combat money laundering and terrorist financing.

2.1.4 SRO-SIA Rules

The R SRO-SIA specifies the obligations of insurance undertakings to combat money laundering and terrorist financing, in particular the obligations under the AMLA and the AMLO-FINMA.

2.1.5 How do these regulations interact?

Switzerland's Legislative Framework on AML targeting insurance companies can be seen as a pyramid. As a basis you have the SCC, which outlines what money laundering and terrorist financing is and what must be considered a predicate offence to money laundering and terrorist financing as well as the scope of the punishment to be imposed in a given case.
According to Art. 164 Para.1 of the Federal Constitution *"[…] All significant provisions that establish binding legal rules must be enacted in the form of a federal act."* Based on the punishable conduct as defined in the SCC, the Federal Assembly of the Swiss Confederation, issued the AMLA which regulates the combating of money laundering, the combating of terrorist financing as defined in and the due diligence required in financial transactions.
Pursuant to Art. 182 Para. 1 of the Federal Constitution *"[…] The Federal Council enacts legislative provisions in the form of ordinances, provided it has the authority to do so under the Constitution or the law."*
In the Federal Constitution Art. 95 says *"[…] The Confederation may legislate on professional activities in the private sector"* and Art. 98 Para. 3 it has been

specified that *"[…] The Confederation […] shall legislate on private insurance."* Based on this provisions the Federal Assembly of the Swiss Confederation, issued the Financial Market Supervisory Act (FINMASA). Art. 1 Para. 1 lit. f of the FINMASA clarifies that *"[…] The Confederation shall create an authority for the supervision of the financial markets in accordance with the following acts (the financial market acts):..f. Anti-Money Laundering Act of 10 October 1997."* The FINMASA further specifies under Art. 7 Para. 1 lit. a, that *"[…] FINMA exercises its regulatory powers by issuing: a. ordinances, where so provided in the financial market legislation; […]".* Based on this provisions in connection with Art. 17 and Art. 18 Para 1 lit. e AMLA FINMA issues the AMLO-FINMA, which specifies how financial intermediaries according to Art. 3 Para. 1 must implement the obligations to combat money laundering and terrorist financing. Financial intermediaries according to Art. 3 Para. 1 lit. a are financial intermediaries according to Art. 2 Para. 2 lit a-d AMLA. Considering Art. 2 Para. 2 lit c AMLA, which mentions *"[…] insurance institutions as defined in the Insurance Supervision Act of 17 December 2004 that deal in direct life insurance or offer distribute shares in collective investment schemes;[...]".*

In line with Art. 18 Para. 1 AMLA FINMA acknowledged the establishment of the Self-Regulatory Organization of the Swiss Insurance Association and approved the R SRO-SIA, which specifies the obligations to combat money laundering and terrorist financing for the insurance sector. In particular, the obligations under the AMLA and the AMLO-FINMA (SRO-SIA, 2015). The R SRO-SIA is the ultimate and most granular piece of legislation regarding AML/CTF for the Swiss insurance industry.

Figure 1: Switzerland's Legislative Framework on AML for Insurance Companies

2.2 Recent Developments

The following table should illustrate the most important milestones in relation to the ongoing changes to the Swiss AML legislation, which are of relevance for the insurance industry.

Date	Milestone
01.06.2018	Federal Council initiated the consultation on amendments to the AMLA (consultation closed since 21 September 2018)
26.06.2018	Approval by FINMA of the R SRO-SIA (effective as of 1 January 2020)
18.07.2018	Publication of the partially revised AMLO-FINMA (effective as of 1 January 2020)

Table 2: Ongoing changes to the Swiss AML legislation

2.2.1 FATF's Mutual Evaluation 2016

In early 2016 (February – March) the FATF conducted an on-site visit to analyze the level of compliance with the FATF 40 Recommendations and the level of effectiveness of Switzerland's AML/CTF system. In December 2016 the FATF published a report which summarizes the AML/CTF measures in place in Switzerland at the date of the on-site visit (FATF, 2016). Out of the eight key findings identified by the FATF the most important ones are (FATF, 2016):

- *Swiss authorities generally have a good understanding of the risks of ML/TF;*
- *The Swiss financial system is exposed to a high risk of ML (especially private banking);*
- *The Swiss AML/CTF framework has been developed using a risk-based approach and Swiss authorities take identified risk into account in their objectives and activities;*
- *FINMA needs to increase supervision and sanctions regarding compliance with the reporting requirement (suspicious transactions); and*
- *FINMA's sanction policy for serious violations of AML/CFT obligations remains inadequate (not proportionate and sufficiently dissuasive).*

FATF's mutual evaluation report, which flagged that 25 out of 40 FATF-Recommendations as "largely compliant", 6 out of 40 "compliant" and 9 as "partially compliant" (FATF, 2016). Due to this result Switzerland was put under an "enhanced follow-up procedure[5]", where the FATF expects Switzerland to resolve the majority of the flagged issues regarding "technical compliance[6]" until February 2020. In 2020, Switzerland will be subject to another on-site visit by the FATF to test the effectiveness of its amendments to the AML/CTF framework (Federal Council, 2018b, p. 7). This is why currently that many pieces of Switzerland's AML legislation are under development. More details on the changes can be found under the following sections (2.2.2 – 2.2.4).

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[5] "*Enhanced follow-up, involving a more intensive process of follow-up, for countries with significant deficiencies, or countries making insufficient progress. In deciding whether to place a country in enhanced follow-up, the Plenary should consider both the level of technical compliance and of effectiveness reached by the country." (FATF, 2017a, p. 8).*

[6] *"Technical Compliance Ratings (C - compliant, LC – largely compliant, PC – partially compliant, NC – non compliant)" (FATF, 2016, p. 11).*

2.2.2 Revision of the Swiss Anti-Money Laundering Act

Before going into the details of amendments of what the current version, which has been published for consultation, will foresee. The author wants to provide a brief overview on where and in which phase of the legislative process the revised AMLA currently stands.

The legislative process in Switzerland can in principle be divided into three phases and eleven partial steps (Parliament, 2015a).

According to the ParlA (Federal Act on Federal Assembly) the three phases can be divided into initiative phase, elaboration phase and review phase.

The Federal Council initiated the consultation on amendments to the AMLA on 1 June 2018 and it lasted until 21 September 2018 (Federal Council, 2018a).

The Federal Council issued the draft law by the end of June 2019 and submitted it to the two Councils (National Council and Council of States) together with dispatch. Following the final vote, the laws will be published in the Federal Gazette (BBI) (Parliament, 2015a).

If the optional referendum pursuant to Article 141 of the Federal Constitution is not held, it is published in the official collection with a reference to the date of entry into force (Parliament, 2015b).

Before a new or revised federal law can be enacted in Switzerland, such as the AMLA, the Federal Constitution of the Swiss Confederation must be considered. Articles 140 and 141 of the Federal Constitution regulate both the mandatory and the optional referendum.

The AMLA is a Federal Act and therefore Art. 141 para. 1 lit. a applies and is therefore subject to an optional referendum. The requirements for enacting a federal law are derived from Article 164 of the Federal Constitution.

Article 141 regulates the requirements for an optional referendum. An optional referendum is held if at least 50,000 Swiss voters or eight cantons request it within 100 days of the official publication of the decree.

If one of these conditions is fulfilled, the following matters are submitted to the Swiss electorate for a vote:

a) federal laws

(b) federal acts declared urgent, the period of validity of which exceeds one year

(c) federal decrees, if provided for by the Constitution or by law

(d) international treaties which:

1. are indefinite and irrevocable
2. provide for accession to an international organization
3. contain important legislative provisions or whose implementation requires the enactment of federal laws.

According to the current status of the revision of the AMLA, the following chapter will provide an analysis of the changes based on the draft law, which has been published for the official consultation in June 2018.

2.2.2.1 Key Changes foreseen

It is important to note that the limited scope of the present thesis presupposes a focus on the analysis with a special focus on the insurance industry. That is why not all the proposed changes will be analyzed. The main changes from the perspective of the insurance industry that the Federal Council proposed in the consultation on amendments to the AMLA, are as follows:

- In order to respond to the criticism of the FATF (refer to section 2.2.1) Art. 4 Para. 1 AMLA of the draft law proposes to amend the existing legal requirement to ensure that obligation to verify the beneficial owner receives an explicit legal basis (Federal Council, 2018c);
- A general and explicit obligation to periodically update the customer file (KYC Data) should be included under Art. 7 Para. 1bis AMLA according to the draft law (Federal Council, 2018c); and
- In addition, the provision under Art. 305ter paragraph 2 SCC regarding the reporting of the suspicious activity reports for money laundering and terrorist financing to the Money Laundering Reporting Office Switzerland

(MROS) should be abandoned and summarized under the existing provision of Art. 9 AMLA (Federal Council, 2018b).

Those are the points that the author of this thesis identified as the most critical ones for the insurance industry and where one could expect most of the participants of the consultation have been commenting on.

2.2.3 Revised FINMA Anti-Money Laundering Ordinance

In light of FATF's findings FINMA has revised and published in July 2018 its AMLO-FINMA which will enter into force on 1 January 2020. The changes to the ordinance are part of an overall package with the main purpose to strengthen the financial intermediaries' group wide AML oversight and to include measures resulting from the FATF's evaluation report on Switzerland. It also specifies the due diligence measures which must be put in place if domiciliary companies or complex structures are used or if there are links with high-risk countries (FINMA, 2018a).

The main changes from the perspective of the insurance industry:

- **Comprehensive global report and risk assessment:** The AMLO-FINMA specifies obligations for financial intermediaries with foreign branches or subsidiaries to monitor legal and reputational risks (related to AML) on a global basis and to issue an annual assessment report. Such a report should include a sufficient amount of quantitative and qualitative indicia. Quantitative indicia for such group-wide monitoring should include data for specific types of customer groups (i.e. number of high-risk customers or number of PEPs), number of Suspicious Transactions Reports; qualitative indicia could be changes of the inherent risk or local AML incidents. Further, this report will need to be approved according to Art. 25 Para. 2 AMLO-FINMA, by Senior Management or the Board of Directors on an annual basis (FINMA, 2017, p. 11 f.);
- **On-site monitoring:** The AMLO-FINMA also requires that the Compliance Function on a group level conducts periodic risk-based 2nd line of

defense on-site monitoring in foreign branches or subsidiaries, including sample checks on individual local business relationships (FINMA, 2017, p. 13 f.);

- **Ad-hoc reporting:** Foreign branches or subsidiaries need to provide the head office with ad-hoc reports on a case-by-case basis of significant transactions, and other significant changes in legal and reputational risks (FINMA, 2017, p. 12 f.);
- **Risk management measures:** The use of domiciliary companies[7] may constitute increased AML-related risks. The company assesses the reason for the use of a domiciliary company in a business relationship including policy, account or transaction, as applicable (FINMA, 2017, p. 17 f.); and
- **Special duties of due diligence:** Business relationships or transactions involving countries that are considered by the Financial Action Task Force (FATF) as *"[…] countries or jurisdictions[8] with such serious strategic deficiencies that the FATF calls on its members and non-members to apply counter-measures […]"* (FATF, 2018c) require the application of Enhanced Due Diligence (FINMA, 2017, p. 23 ff.).

The above list is not a complete list of changes, however the points that the author of this thesis identified as the changes with the biggest impact for the insurance industry both in terms of resources needed to implement the changes and also to ensure operational effectives of the additional controls required going forward.

[7] e.g., offshore Trust companies, foundations, institutions, etc. (FINMA 207, p. 26 f.)

[8] April 2019: Democratic People's Republic of Korea (DPRK) and Iran (FATF, 2018c)

2.2.4 Regulation of the Self-Regulatory Organization of the Swiss Insurance Association

The revised R SRO-SIA, which will be effective as of 1 January 2020 has been approved by FINMA (the supervisory body of the SRO-SIA) on 26 June 2018 and includes respectively specifies the changes coming from the revised AMLO-FINMA, why we at this point will not provide a detailed analysis of the changes incorporated. It is expected that due to the ongoing revision of the AMLA further changes must be included in the latest version (SRO-SIA, 2018a).

3 European Unions' AML/CTF System

In the following chapter, one would like to give an overview of the current legislative framework around the AML legislation in the EU (on a Union level only). It is focusing on the main Directive (EU) 2015/849 of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and the revised version of the respective Directive (EU) 2018/843, with a special focus on the insurance sector. In addition, an analysis on the current developments and an outlook on "What is to come" will be provided. The constitutional basis will only be provided on a high level and not very granular.

3.1 Current legislative framework

The current legislative framework which regulates the combating of money laundering and terrorist financing for the insurance industry in the EU on a Union level consists at the moment of one main Directive (EU) 2015/849 and one (Directive (EU) 2018/843) which is currently to be transposed by the Member States in their national legislative framework. In addition, another important part of the Directive (EU) 2015/849 is the Commissions Delegated Regulation (EU) 2016/1675, which is supplementing the Directive (EU) 2015/849 by identifying high-risk third countries with strategic deficiencies. This Delegated Regulation has since been amended several times and the latest version is currently Delegated Regulation (EU) 2018/1467.

3.1.1 From Union to national law

Before going further into the detail of the 4th and 5th Anti-Money Laundering Directive (4th and 5th AMLD), it is important to note that the EU has various types of legal acts, including directives. Under Article 288 of the Treaty on the Functioning of the European Union (TFEU), the EU institutions shall adopt five types of legal acts to exercise the Union's competences. The five types of legal acts according to Art. 288 TFEU are:

- the regulation;
- the directive;
- the decision;
- the recommendation; and
- the opinion.

The regulations, directives and decisions are binding legal acts, while the recommendation and the opinion are not. Because for the prevention of the use of the financial system for the purposes of money laundering or terrorist financing the EU decided to issue a directive (AMLD), which forms part of the EU's secondary[9] law, we will focus on the applicability, adoption and transposition into national law of EU directives.

Once a directive is adopted by the Council and the Parliament under the ordinary legislative procedures at EU level, it has then to be transposed by the EU Member States that it becomes national law (EUR-Lex, 2018). In case of the AMLD the EU addressed the directive to all EU Member States and therefore every Member State needs to develop/amend its own national law on AML. However, the national law must according to Art. 288 TFEU achieve the objective set by the directive and must be transposed by the deadline set when the directive was adopted. When having it adopted national authorities must communicate these to the European Commission (EUR-Lex, 2018). Should a Member State fail to transpose a directive the EU according to Art. 259 TFEU may initiate infringement proceedings and bring proceedings against the Member State before the Court of Justice of the EU (the Court). In principle, a directive is only effective once it has been transposed to national law. However, the Court in some instances where a directive has not yet been transposed into national law can still produce certain direct effects when:

[9] as defined under Arti.288 of the Treaty on the Functioning of the European Union (TFEU).

- *"[…] the transposition into national law has not taken place or has been done incorrectly;*
- *the terms of the directive are unconditional and sufficiently clear and precise; and*
- *the terms of the directive give rights to individuals." (EUR-Lex, 2018)*

Should these conditions be met, individuals may relay on the directive against an EU Member State in court. Important to note is that an individual may not rely on making a claim against another individual with respect to the direct effect if a directive has not yet been transposed into national law (CJEU, C-91/92, paras 11-30).
Under certain conditions, the Court also allows individuals the possibility of obtaining compensation for directives, which have been transposed poorly or delayed (CJEU, C-6/90 and C-9/90, paras 4-46).

3.1.2 4th Anti-Money Laundering Directive

As outlined already in section 3.1 of this thesis, the Directive (EU) 2015/849 aims to prevent the use of the Union's financial system for the purpose of money laundering and terrorist financing.
The Directive (EU) 2015/849 has first been published in the Official Journal of the European Union by 5 June 2015 and had to be transposed by the EU Member States in their national legislative framework by 26 June 2017 (OJ L 141/73).

3.2 Recent Developments

The following table should illustrate the most important milestones in relation to the ongoing changes to the EU's AML legislation, which are of relevance for the insurance industry.

Date	Milestone
19.06.2018	5th AMLD has been published in the Official Journal of the EU (to be transposed into national law by 10 January 2020)
12.09.2018	EU Commission proposes to expand the authority of the European Banking Authority (EBA)
02.10.2018	EU amends its original Delegated Regulation (EU) 2016/1675, as regards adding Pakistan to the list of high-risk third countries
14.03.2019	EU Council rejects the revised high-risk third country list that the EU Commission adopted
21.03.2019	EU Commission announcement on the agreement reached by the European Parliament and Member States on the core elements of the reform of the European supervision in the areas of EU financial markets including when it comes to anti-money laundering

Table 3: Ongoing changes to the EU's AML legislation

3.2.1 5th Anti-Money Laundering Directive

The Directive (EU) 2018/843 has first been published in the Official Journal of the European Union by 19 June 2018 and has to be transposed by the EU Member States in their national legislative framework by 10 January 2020 (OJ L 141/73).

The changes to the 4th AMLD are part of an action plan launched after a spate of terrorist attacks in Europe in 2016 and responds to the Panama Papers revelations (Council Directive 2018/843/EC).

The main changes from the perspective of the insurance industry:

- **Beneficial ownership:** Increase access to information on beneficial ownership of companies and trusts to prevent money laundering and terrorist financing (Council Directive 2018/843/EC);
- **Financial Intelligence Units:** Increase cooperation and work between FIUs by enhancing their power and access to data (Council Directive 2018/843/EC);

- **Terrorist Financing:** Tackle TF by extending AML/CTF rules to virtual currencies, prepaid cards and tax related services (Council Directive 2018/843/EC); and
- **High-risk third countries:** Ensure a common high level of safeguards for financial flows by improving checks on transactions involving high-risk third countries (Council Directive 2018/843/EC).

There have been some other changes compared to the 4th AMLD. However, the above list should highlight the key changes for the insurance industry.

3.2.2 Expansion of the European Banking Authorities' Role

Although the EU says with the adoption of the 4th AMLD, which is in force since June 2017 and the 5th AMLD, which has to be transposed by January 2020, they have considerably strengthened the EU regulatory framework, including rules on cooperation between AML and prudential supervisors, the Commission on 12 September 2018 released its proposal to expand the authority of the EBA with respect to AML/CTF (European Commission, 2018b). The proposal is part of a broader strategy to strengthen the EU framework of AML supervision for financial institutions. The proposal consists of legislative and non-legislative measures to ensure effective cooperation and convergence of supervisory standards in the area of anti-money laundering (European Commission, 2018b).

When issuing the proposed legislative amendments the Commission stressed that the proposal should be considered by the European Parliament and the Council in the ongoing legislative negotiations on the Commission's proposal to review European Supervisory Authorities' (ESAs) Regulations, adopted in September 2017 (European Commission, 2018b).

In March 2019, the Commission announced that the European Parliament and the Member States reached a political agreement on the core elements of the

reform of the European supervision in the areas of EU financial markets including when it comes to AML (European Commission, 2019a). As a next step, based on this political agreement before the European Parliament and the Council can adopt the final text of the new Regulation, there is still some additional technical work to be done.

The key changes to the current EU AML framework and role of the EBA under the new rules would be the following:

- **Single EU Supervisor:** The EBA would act as the single EU-Level AML/CTF supervisory authority with respect to financial institutions (i.e., banks, insurers and investment firms), as it is in the banking sector that ML/TF risks are most likely to have a systemic impact. Final decisions on matters relating to AML/CTF under competence of European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA) will be taken in agreement (European Commission, 2019b);
- **Investigations:** The EBA would have the authority to:
    - In cross border AML/CTF matters with third countries, assume a leading role in facilitating cooperation between national authorities and the relevant authorities in third countries; and
    - Where it has indications of material AML/CTF breaches by a financial institution, request a national authority to investigate and to consider imposing sanctions or other actions (European Commission, 2019b);
- **Monitor:** The EBA would have the authority to monitor market developments and assess vulnerabilities to AML/CTF in the financial sector (European Commission, 2019b);
- **Standards:** The EBA would have the authority to develop common standards for AML/CTF in the financial sector and promoting their consistent implementation (European Commission, 2019b);
- **Data collection:** The EBA would have the authority to:

  - Collect information from national authorities relating to weaknesses identified in the processes and procedures, governance arrangements, fit and proper assessments, business models and activities of financial institutions with respect to AML/CTF;
  - Collect information from national authorities regarding measures taken by in response to such weaknesses; and
  - Establish a central database of this information which would be available to national authorities on a need-to-know and confidential basis (European Commission, 2019b);
- **Oversight of National Authorities:** The EBA would have the authority to:
  - Promote convergence of supervisory processes over AML/CTF, including by conducting periodic reviews of national authorities; and
  - Regularly perform risk assessments of national authorities to test their strategies and resources to address and monitor the most important emerging risks related to AML/CTF (European Commission, 2019b).

The Commission highlights that these changes will bring major improvements to the supervisory framework of AML risks and contribute to risk reduction in the financial sector (European Commission, 2019b).
Important to note is that according to the Commission, this reform will not change the strong role for national authorities in many areas of supervision. The new system should improve the ability of national authorities to maintain the necessary standards of financial supervision and in addition ensure that similar supervisory standards are applied in all other EU Member States. Following the support by the ESAs, national authorities will be able promote sustainable finance and stay on top of the developments in the area of FinTech and other new developments (European Commission, 2019b).

Figure 2: European Financial Supervisory Architecture (European Commission, 2019b)

4 Global AML/CTF System

The purpose of this chapter is to introduce two of the main actors in the field of international standard stetting on AML/CTF regulations the Financial Action Task Force (FATF) and the Institute of International Finance (IIF). The aim is to give a brief introduction on the two players, analyze their objective respectively their mission and highlight the work that they are doing in the field of AML/CTF regulations.

4.1 Financial Action Task Force

The FATF an inter-governmental body, which was initially established in 1989 by the Ministers of its Member jurisdictions at the G-7 Summit that was held in Paris, has the objective to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to integrity of the international financial system. Therefore, the FATF can also be seen as a "policy-making body", which aims to initiate regulatory reforms in these areas (FATF, 2018d). The establishment of the FATF was probably the most important step to ensure an aligned system to combat ML and TF. Currently the FATF has 38 members (36 jurisdictions and 2 regional organizations), which represent most of the major financial centers around the world (FATF, 2018b).

So far the FATF was operating under a fixed life-span, requiring a specific decision by its Ministers to continue. On the 30th anniversary of the FATF in April 2019, the Ministers agreed on an open-ended mandate for the FATF. This underlines the leading role to push actions to counter ML/TF and the financing of proliferation of weapons of mass destructions globally (FATF, 2018e).

4.1.1 Standing and Perception

Not just the open-ended mandate but also that the FATF members agreed to greater ministerial engagement, additional support through regular and more

frequent ministerial-level meetings, an extension of the term of the FATF Presidency, and by agreeing to a new funding model for the organization shows the standing of the FATF (FATF, 2018e). Another indicator is the increase in Membership. When the FATF started they had 16 members and over the past years they expanded to the current 38 members (FATF, 2018b).
In addition, the point that comes up when analyzing new laws and regulations on AML/CTF and is in the authors view the most important one to demonstrate the FATF's standing, is the following. Most recent changes on the main parts of the legislative system around AML within Switzerland (FINMA, 2017) and the EU (Council Directive 2015/849/EC) consistently show the references to the FATF Recommendations, which will be further explain in the next chapter 4.1.2 on the Methodology and Instruments of the FATF. Based on all this indicators it becomes clear that the standing and perception of the FATF at least currently is very strong.

4.1.2 Methodology and Instruments

The methodology and the instruments of the FATF can be split into three different buckets. One is that the FATF monitors countries' progress in implementing the FATF Recommendations, they review ML/TF techniques and countermeasures and they promote the adoption and implementation of the Recommendations globally (FATF, 2018f).
The most important and probably the strongest instrument that the FATF is using is the set of currently 40 Recommendations, which have been issued last time in 2012 and over 200 countries committed to these Recommendations (FATF, 2018g). These Recommendations were drawn up one year after the establishment of the FATF in 1990. Since then they went through various stages and developed to strengthen the requirements for higher risk situations and to allow countries to take a more focused approach in areas where high risks remains or implementation could be enhanced (FATF, 2018a, 6 ff.).

Figure 3: Development of the FATF Recommendations (FATF, 2018b)

Although the FATF puts out a standard on AML/CTF they require the countries to first identify, assess and understand the risks of ML and TF and based on that adopt appropriate mitigating measures. This so called "risk-based approach" allows the countries to adopt measures which are more flexible and more effective to prevent the risks but are still within the framework of the FATF (FATF, 2018a, 7).

Besides the Recommendations the FATF also issues Guidance's, Best Practice Papers and other advice to assist countries with the implementation of the FATF standards (e.g., Private Sector Information Sharing Guidance or Guidance for a Risk-Based Approach for the Life Insurance Sector) (FATF, 2018a, 7).

The other instrument used by the FATF to achieve global implementation of the Recommendations is the monitoring of the effective implementation. To achieve global implementation the FATF relies on a strong global network of FATF-Style Regional Bodies (FSRBs). The total nine FSRBS are providing expertise and input in FATF's policy-making and promote the effective implementation of the FATF Recommendations (FATF, 2018g). The implementation is assessed through Mutual Evaluation processes by the FATF, FSRBs and through the International Monetary Fund and the World Bank all on the basis of the FATF's common assessment methodology (FATF, 2018a, 7).

These are the main instruments used by the FATF to ensure the adoption and implementation of the Recommendations globally. The potential consequences

of a non-favorable result in the Mutual Evaluation, will be further discussed in the section 6.3.2 on Blacklisting of high-risk countries.

4.2 Institute of International Finance

The Institute of International Finance (IIF) is the global association of the financial industry. IIF's close to 450 members from 70 countries include commercial and investment banks, asset managers, insurance companies, sovereign wealth funds, hedge funds, central banks and development banks (IIF, 2018a). IIF, as the leading voice for the financial services industry, is engaging with global standard setters and policymakers to advocate for regulatory, financial and economic policies that are in the broad interests of its members and foster global financial stability and sustainable economic growth. In addition, IIF tries to support the financial industry in the prudent management of risks and to develop sound industry practices (IIF, 2018a).

4.2.1 Standing and Perception

To make a clear and well-founded statement on the standing and perception of the IIF is difficult. They have a very global footprint with offices in the United States of America, the United Arab Emirates, China, Singapore and Europe (IIF, 2018a). Looking at the activities and the regular interactions of IIF with various regulators globally and also their engagement in setting up regulatory committees and working groups (e.g., on AML/CTF) they seem to be quite active. In addition, considering the representatives of their Board of Directors and Executive Committee which is composited of Chairman's of the Board of Directors and Chief Executive Officers of some of biggest players in the financial Industry (e.g., UBS Group AG, Allianz SE, Bank of China, HSBC Holdings PLC, etc.) it seems that the IIF is very well accepted and has a strong standing in the industry.

4.2.2 Methodology and Instruments

IIF is categorizing their activities in three main buckets advocacy, research and networking (IIF, 2018a). Under advocacy they summarize their activities around providing industry input and feedback to global standard setters and policymakers. They facilitate the setting up of working groups and committees between industry peers which then can interact with public sector representatives. The IIF summarizes industry concerns on new and/or amended regulations and participates in public consultations. In addition, they do industry wide surveys, issue regulatory reports and discuss the results of such surveys in meetings or roundtables with regulators globally (IIF, 2019). Another service that the IIF offers is an independent source of global economic and financial research including a comprehensive assessment of the global outlook with a focus on key emerging economies, timely analysis of capital flows to emerging markets and developments in international financial market. IIF is offering first-hand insights from their interactions with policymakers, member firms and the close involvement in the global regulatory debate (IIF, 2018b). For the networking element the IIF regularly holds events around the world to bring senior industry leaders and key policymakers together. The purpose of the meetings, which IIF calls its hallmark, is to facilitate the discussion between the financial services industry and public officials around innovation, new regulations and how everything goes together (IIF, 2018a). Summarizing what the IIF is doing and how they influence the regulatory reforms around the world, it is definitively not as tangible as the work that FATF is doing. As outlined in the previous chapter FATF can be seen as a “policy-making body”, which aims to initiate regulatory reforms in these areas (FATF, 2018d). On the other hand IIF is a quite well established and well respected association that has a very close connection to access regulators globally and steer, respectively influence discussions amongst regulators based on their strong foothold in the financial services industry.

5 Interaction between Swiss and EU Anti-Money Laundering Regulation

In this chapter we will briefly discuss the interaction between the Swiss and the European AML Regulation and based on that highlight areas, where the collaboration could be improved.

Although Switzerland is not a member of the EU and therefore, does not need to implement the EU AMLD, it maintains a close relationship at political, economic and cultural levels. These relations are governed by a set of bilateral agreements and arrangement which most of them are in place since years.

This agreements are the basis of the bilateral administrative assistance and allow that the FIUs of Switzerland and the EU Member States share information in case of suspicious activity reports that they received by the financial institutions based in their territory of competence. How and under which circumstances the Money Laundering Reporting Office Switzerland (MROS) is allowed to cooperate with foreign reporting offices is governed in Art. 30 of the Swiss AMLA in conjunction with the Ordinance on the Money Laundering Reporting Office.

The MROS issued its annual report 2018 in April 2019 and reports that in 2018 they received 795 requests for information by FIUs of 104 different countries (Federal Council, 2019, p. 12).The number of request has more than doubled since 2011 (Federal Council, 2019, p. 12). MROS itself requested information by foreign FIUs on average 131 times per month (Federal Council, 2019, p. 12). Unfortunately, these numbers are not split into different counties, why it is not possible to show how many request came or went from/to FIUs based in the EU but one could imagine that due to the geographical presence of Switzerland a high number of these request were addressed or coming from FIUs operating in the EU.

Comparing the Swiss[10] and the EU framework[11] on AML/CTF as described in section 2 and 3 of this thesis the main part of the regulations itself are similar. This can be explained because both of regulatory bodies are referring in their laws and regulations to the FATF-Recommendations (Council Directive 2015/849/EC & (FINMA, 2017)), which means that both aim to follow and implement the same standards. However there are differences and the most impacting operational differences between the Swiss AMLA and the 4th AMLD can be identified in the following areas (please note that the set-up of the supervision will be disregarded in the following overview):

- **High-risk third country list:** The revised AMLO-FINMA under Art. 13 and the revised R SRO-SIA in Art. 13bis, which will be effective as of 1 January 2020 requires that Swiss insurance companies apply EDD on policyholders, beneficial owners or beneficiaries that are established or are being established (due to change of residency) in a "high-risk" country[12] according to the FATF. In addition, Art. 13ter R SRO-SIA requires the application of EDD if a transaction (e.g., payment to/from such a country) involves a "high-risk" country. On the other hand the Directive (EU) 2015/849 and more explicitly the Commissions Delegated Regulation (EU) 2016/1675, which is supplementing the Directive (EU) 2015/849 by identifying "high-risk" third countries with strategic deficiencies, defines its own list of countries that requires insurance companies to apply EDD on the same scenarios then the R SRO-SIA. The differences of the approach and methodology between the EU's and the FATF's high-risk country list will be further analyzed in section 6.3.2 of this thesis;

[10] Swiss Anti-Money Laundering Act and FINMA Anti-Money Laundering Ordinance

[11] Directive (EU) 2015/849 and Directive (EU) 2018/843

[12] "[…] *countries or jurisdictions with such serious strategic deficiencies that the FATF calls on its members and non-members to apply counter-measures […]"* (FATF, 2018c)

- **Politically Exposed Persons:** For Politically Exposed Person (PEP) as defined in the glossary Art. 20 of the Directive (EU) 2015/849 requires not only "senior management"[13] approval but also that the institutions apply EDD. In line with the Directive (EU) 2015/849 also the R SRO-SIA under Art. 13bis and Art. 15 requires that an insurance company applies EDD and escalates the customer relationship to its senior management. However, the difference is that the R SRO-SIA applies three different definitions for PEPs (Foreign, Domestic and International organization), in line with FATF's Guidance on Politically Exposed Persons (FATF, 2013, p. 4 f.). For domestic and international organization PEPs Art. 13bis and Art. 15 of the R SRO-SIA specifies that the senior management approval is only to be requested if there is an additional risk factor such as a high-volume contract; and
- **Customer identification:** In Art. 4 of the R SRO-SIA is defined that the insurance company or the intermediary of the insurance company needs to establish a copy of the identification document (e.g., passport or ID-card) or records the details such as type of identity document, issue number, place and country of issuance. However, Art. 40 of the Directive (EU) 2015/849 goes even beyond that and requires a copy of the identification document to be stored in the customer file.

This should illustrate that even if both frameworks are committed and want to be aligned to the FATF Recommendations there are differences in the translation into local in case of Switzerland or Union law.

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[13] *"[…] an officer or employee with sufficient knowledge of the institution's money laundering and terrorist financing risk exposure and sufficient seniority to take decisions affecting its risk exposure, and need not, in all cases, be a member of the board of directors […] " (Council Directive 2015/849/EC)*

5.1 What could be improved?

Based on the points of interaction that have been explained above there is in the authors view not much to improve in relation to the interaction between the Swiss and the EU AML policy makers. What is more critical in the authors view is that the EU is issuing its regulation on AML/CTF as a Directive and not as a Regulation, which still leads to various different interpretations. Although, this should not be the case in reality there are differences e.g., on the definition of senior management. The 4th AMLD defines senior management as "[…] *an officer or employee with sufficient knowledge of the institution's money laundering and terrorist financing risk exposure and sufficient seniority to take decisions affecting its risk exposure, and need not, in all cases, be a member of the board of directors […]"* (Council Directive 2015/849/EC), which is usually a member of the Business, whereas in the German Anti-Money Laundering Act considers the Money Laundering Reporting Officer according to Art. 7 as part of the senior management, who is at least in bigger organizations usually part of Compliance and not of the Business.

6 Challenges and Future Trends

The purpose of this chapter is to on the one hand analyze which the regulators are that are dealing with innovation and other developments such as new currencies in the past and what they could improve considering the recent developments in that field. On the other hand, one would like to illustrate areas where regulators do not seem to act only considering a certain level of risk that their area or territory of responsibility seems to face but also other, mainly political factors.

6.1 Balance between Regulation and Innovation

When one is looking at the most recent developments of AML/CTF regulations in Switzerland and the EU it is quite difficult to find many examples for over or under regulating. Both the Swiss and the EUs regulatory bodies seem to be more responsive to new trends coming up then proactively addressing them. Therefore, the author tries to outline certain specific examples, where the regulators based on specific issues that came up, tried to react with putting in place new or enhanced regulations instead of acting proactively.

6.1.1 How and when do the Regulators need to intervene?

In the past two to three years there have been many instance of alleged money laundering not just globally but also in Europe and in Switzerland. This becomes even more transparent when looking at the global statistics of fines related to AML compliance failures that were imposed in 2017 and 2018. Debevoise & Plimpton LLP an international law firm based in New York publishes an annual report that not only shows the total of fines imposed but also should assist financial institutions in understanding the evolving AML priorities of law enforcement and financial regulators (Debevoise & Plimpton, 2019, p. 1). The 2017 report shows that in total more than USD 2 billion of fines related to AML compliance were imposed (Debevoise & Plimpton, 2018, p. 1) and the figures for 2018 that show USD 2.9 billion even surpassed this numbers (Debevoise & Plimpton, 2019, p. 1).

To combat this trend but also to anticipate the risk that certain trends bring (e.g., Crypto Currencies) regulators in the EU and Switzerland try to come up with more stringent regulations to be able to prevent the use of the financial system for the purpose of ML and TF. However, when we look at the most recent actions that regulators in the EU and Switzerland put in place then we realize that so far it seems like they are more reacting instead of proactively acting to issues that come up and jeopardize the financial system. To illustrate that we focus on the revised AMLO-FINMA, the 5th AMLD and the recent initiative from the European Commission in relation to the strengthening of EBAs role and the Action Plan on AML that the EU Council put in place in December 2018.

Date	Action	Reference to issues/scandals
04.09.2017	FINMA initiated consultation of the partially revised AMLO-FINMA (effective as of 1 January 2020)	*"[…] As investigations by FINMA in connection with recent* ***money laundering scandals (1MDB, Petrobras, etc.)*** *have shown some financial institutions do not carry out systematic or risk-based internal controls in their branches and group companies […]"* (FINMA, 2017, p. 13 f.)
19.06.2018	EU published 5th AMLD in the Official Journal of the European Union	The changes to the 4th AMLD are part of an action plan launched after a spate of ***terrorist attacks in Europe in 2016 and responds to the Panama Papers revelations***

		(Council Directive 2018/843/EC).
04.12.2018	EU Council issues an Action Plan on AML including 8 short-term actions (timeline until January 2020)	*"[…] REGRETS however that **there have been a number of instances of alleged money laundering involving EU banks** which underline the need to strengthen the effectiveness of the current framework […]"* (Council Conclusion, ST 15164/18)
21.03.2019	EU Commission announcement on the agreement reached by the European Parliament and Member States on the core elements of the reform of the European supervision in the areas of EU financial markets including when it comes to anti-money laundering	*"[…] While the EU has strong anti-money laundering rules in place, **recent cases involving money laundering in some EU banks have raised concerns** that those rules are not always supervised and enforced effectively across the EU […]"* (European Commission, 2019b)

Table 4: Regulatory Intervention EU/Switzerland

In addition, to the above mentioned scandals that led the European and the Swiss regulators intervening in the form of new or strengthened requirements, we should consider the rapid development of the range of financial service providers in the field of virtual currencies also called crypto currencies. The EU Commission through the 5th AMLD (Council Directive 2018/843/EC), FINMA

with the issuance of their guidelines for enquiries regarding regulatory framework for initial coin offerings (ICOs)[14] in 2018 (FINMA, 2018c) and the FATF, with its work on the clarification of FATF Recommendation 15 (FATF, 2019), tried to control the ML/TF risk that arises with the more frequent use of crypto currencies. Further details on the regulation of new currencies can be found in section 6.2.2 of this thesis.

Considering the above it seems that regulators are so far not able to anticipate either new trends through innovation or existing weaknesses in the system that could be a potential threat to the financial system. This was the case for the issue that came up through the Panama Papers revelations and one now tries to tackle, among other things, the gaps that became transparent, by more stringent requirements around the disclosure of beneficial owners of a legal entity (e.g., 5th AMLD) but also with the developments in the area of crypto currencies. Regulators needed two to three years to publish appropriate regulations to mitigate these risks of ML/TF and bring them under control. That there would be another and potentially more efficient way on how to deal with innovation or new trends should be briefly illustrated in the next section.

6.1.2 Are there other ways to regulate?

In a short digression before we return to the main topic of this thesis, the author wants to give an example on what other ways exist on how regulators can on the one hand intervene when new trends come up (e.g., FinTech companies) that potentially could be a threat to the financial system and on the other hand boost these new innovative business models. The Swiss Financial Market Supervisory Authority (FINMA) introduced in 2018 (effective as of January 1, 2019) less and more relaxed requirements for institutions that accept public deposits up to CHF 100 million provided that these are not invested and no

[14] ICOs are a digital blockchain-based form of public fund-raising for entrepreneurial purposes (FINMA, 2018f).

interest is paid on them. FINMA published guidelines to simplify the application process for such companies. The license for these FinTech companies will be granted by FINMA and they will also supervise them (FINMA, 2018d). In addition, FINMA based on the changes around separate licensing category amended the AMLO-FINMA and included this new FinTech companies to ensure they follow the same due diligence requirements relating to combat money laundering (FINMA, 2018e). However, also in the amendments to the AMLO-FINMA it was recognized that these companies do not need to follow the same organizational standards and therefore, FINMA introduced some relaxations in that area. These changes did enter into force on January 2019 (FINMA, 2018e).

6.2 New Currencies

In the following section, one would like to analyze the potential risk in relation to ML/TF that new currencies may constitutes with a strong focus on crypto/virtual currencies. Besides that, the purpose is to give a brief overview of the current legislative framework around new currencies covering ML/TF risks that exists on a FATF-level, in the EU and in Switzerland.

6.2.1 Anti-Money Laundering Risk of Virtual Currencies

The FATF in its report on virtual currencies of June 2014 describes the potential vulnerability to ML/TF abuse as follows:

- **Greater anonymity:** Virtual currencies allow greater anonymity than traditional noncash payments methods. They usually allow non-face-to-face customer relationships and may even allow anonymous funding (cash or third-party funding through virtual exchangers that do not properly identify the source of funds). In addition, they permit anonymous transfers, in the case sender and recipient are not adequately identified (FATF, 2014, p. 9);
- **Central oversight body:** Currently there is no central oversight body or AML/CTF software available to monitor and identify suspicious transaction patterns (FATF, 2014, p. 9);

- **Law enforcement:** Although authorities can target individual exchangers for client information that they may have collected, law enforcement cannot target one central location or entity (administrator) for investigative or asset seizure purposes. In addition, customer and transaction records may be held by different entities in different jurisdictions, which makes it even more difficult to access them (FATF, 2014, p. 9 f.);
- **Complex infrastructures:** To transfer funds or execute payments, virtual currencies rely on complex infrastructures that involve several entities, usually spread across several countries, which complicates the responsibility for AML/CTF compliance and supervision even more (FATF, 2014, p. 9); and
- **Location:** Virtual currency systems may be located in jurisdictions that do not have adequate AML/CTF controls. It could even be that some virtual currency systems deliberately seek out jurisdictions with weak AML/CTF regimes that they cannot be held guilty for ML/TF by any strong enforcement authority (FATF, 2014, p. 10).

Based on the above and considering the rapid growth of this industry over the past years it seems clear that there needs to be a more stringent regulatory framework around AML/CTF that includes virtual currencies and the risks this brings to be put in place.

6.2.2 Regulation of Virtual Currencies

Considering the risk in relation to ML/TF that virtual currencies potentially can bring, it seems clear that there is a need for regulation in that area. As mentioned above the purpose is to give a brief overview of the current legislative framework on a FATF-level, in the EU and in Switzerland and provide a brief outlook on what can be expected in terms of regulatory requirements.

FATF at its plenary meeting in October 2018 made the point that it is *"[…] an urgent need for all countries to take coordinated action to prevent the use of virtual assets for crime and terrorism […]"* (FATF, 2018h). The FATF recognized

that although the FATF Recommendations set out comprehensive requirements for combating ML/TF that apply to all forms of financial activity (including virtual currencies), governments and the private sector need more clarity about which activities the FATF standards apply to in this context. Besides minor changes adopted to the Recommendations and some clarification in the glossary of the Recommendations, FATF announced that they will prepare an updated guidance on a risk-based approach to regulating virtual currencies including their supervision, monitoring and *"[…] for operational and law enforcement authorities on identifying and investigating illicit activity involving virtual assets […]"* (FATF, 2018h). In addition, they announced that within the next 12 months they want to review the amended Recommendations and glossary and consider whether further updates are necessary to ensure the FATF Standards stay relevant (FATF, 2018h). Following this announcement, already in February 2019 FATF confirmed that they have now almost finalized the interpretive note and plan to formally adopt this as part of the FATF Recommendations in June 2019 after private sector consultations (FATF, 2019). High-level the changes are that countries for the purpose of applying the FATF Recommendations should consider virtual currencies including all connected parties such as service providers, etc. The countries should understand the ML/TF risks emerging from virtual currencies and based on that take appropriate measures. They should ensure that providers of virtual currencies are subject to adequate regulations and supervision and they need to have proportionate and dissuasive sanctions in place in case companies are not complying with the applicable AML/CTF requirements. The last element is that countries should provide international cooperation in relation to virtual currency providers (FATF, 2019).

FINMA the Swiss Financial Market Supervisory Authority in response to the increase in the number of ICOs planned or executed in Switzerland decided to publish guidelines for enquiries regarding the regulatory framework for initial coin offerings (FINMA, 2018f). The main purpose of these guidelines were to

set out how FINMA intends to apply financial market legislation in handling enquiries from ICOs and define the information they require including guiding principles upon which FINMA will base its response to such enquiries (FINMA, 2018f). When FINMA was analyzing the ICOs that took place or were planned, they found that money laundering and securities regulation are the most relevant to ICOs. FINMA stated that *"[…] Money laundering risks are especially high in a decentralized blockchain[15]-based system, in which assets can be transferred anonymously and without any regulated intermediaries […]"* (FINMA, 2018f). Although, at present, there is no generally recognised terminology for the classification of tokens either in Switzerland or internationally. FINMA categorises tokens into three types, but hybrid forms are possible as well:

- ***Payment tokens:*** *"[…] Payment tokens (synonymous with crypto currencies) are tokens which are intended to be used, now or in the future, as a means of payment for acquiring goods or services or as a means of money or value transfer. Crypto currencies give rise to no claims on their issuer (e.g. Bitcoin) […]"* (FINMA, 2018c, p. 3);
- ***Utility tokens:*** *"[…] Utility tokens are tokens which are intended to provide access digitally to an application or service by means of a blockchain-based infrastructure […] "* (FINMA, 2018c, p. 3); and
- ***Asset tokens:*** *"[…] Asset tokens represent assets such as a debt or equity claim on the issuer. Asset tokens promise, for example, a share*

[15] A blockchain is a type of distributed ledger in the form of a continuously growing list of records based on blocks, which are linked and secured using cryptographic signatures. Each block typically contains a hash pointer as a link to a previous block, a timestamp and transaction data. Blockchains are inherently resistant to data modification. From a functional perspective, a blockchain can serve as an open, distributed ledger that can record transactions between two parties (accounts) efficiently and in a verifiable and permanent way (Zhu, 2017, p. 1).

in future company earnings or future capital flows. In terms of their economic function, therefore, these tokens are analogous to equities, bonds or derivatives. Tokens which enable physical assets to be traded on the blockchain also fall into this category […]" (FINMA, 2018c, p. 3).

Before we go into the outcome of FINMAs assessment regarding applicability of the AMLA a quick recap on objective of the AMLA. *"[…] The objective of the Anti-Money Laundering Act (AMLA) is to protect the financial system from money laundering and the financing of terrorism. Anyone who provides payment services or who issues or manages a means of payment is a financial intermediary subject to the AMLA (Art. 2 para. 3 let. b AMLA)."* (FINMA, 2018c, p. 6).

Based on the above-mentioned criteria (function and transferability), FINMA decided to apply to following approach for the in-scope assessment of crypto currencies under the Swiss AML/CTF regulation.

Pre-Financing and pre-sale / The token does not yet exist but the claims are tradable		**The token exists**
ICO of payment tokens	= Securities ≠ subject to Anti-Money Laundering Act (AMLA)	≠ Securities = means of payment under AMLA* *If the payment tokens can be technically transferred on a blockchain infrastructure.
ICO of utility tokens		≠ Securities, if exclusively a functioning utility token = Securities, if also or only investment function ≠ means of payment under AMLA, if accessory

ICO of asset tokens	= Securities ≠ means of payment under AMLA

Table 5: ICO Compliance with AMLA (FINMA, 2018c, p. 8)

To summarize this would mean that for the following scenarios involving crypto currencies the AML regulation of Switzerland would be applicable (FINMA, 2018c, p. 7):

- Purchase and sale of crypto currencies on a commercial basis (crypto currency to fiat currency[16] / fiat currency to crypto currency / crypto currency to crypto currency)
- Offering of services to transfer tokens if the service provider manages the private key (custody wallet provider)

For insurance companies the following potential scenarios/business cases could be applicable:

Scenario / Business Case	Applicability of the AMLA
Payments of Premiums/Services Development of new products where it would be possible to pay the premiums with crypto currencies (utility token).	**Not applicable** according to Art. 2 para. 2 lit. a sec. 3 AMLO
Currency Exchange Exchange of crypto currency into Fiat-Currency (and vice versa), if an	**Applicable** according to Art. 5 para. 1 lit. b AMLO

[16] Fiat Currency are coins and banknotes that are designated as legal tender and electronic money, of a country, accepted as a medium of exchange in the issuing country (e.g., CHF / EUR / USD / etc.) (Council Directive 2018/843/EC).

insurance company would act as a currency exchange office	
„Insurance-Coin“ Development of an „Insurance-Coin“(if it goes under the category of payment tokens and there is no accessoriness).	**Applicable** according to Art. 4 para. 2 lit. a AMLO

Table 6: ICO Insurance Companies AMLA Applicability

The European Union also recognized the risk linked to anonymous use of virtual currencies and therefore under its 5th AMLD tried to regulate this by extending the scope of the 4th AMLD “[*…] so as to include providers engaged in exchange services between virtual currencies and fiat currencies as well as custodian wallet providers […]”* (Council Directive 2018/843/EC). However, the EU Commission is not yet as concrete as FINMA is in their guidance, they rather stay high-level and do not distinguish between different tokens or anything like that. The Directive under Art. 1 says that *“[…] The Directive shall apply to […] providers engaged in exchange services between virtual currencies and fiat currencies [...]” (Council Directive 2018/843/EC). Art. 47, para. 1 says “[…] Member States shall ensure that providers of exchange services between virtual currencies and fiat currencies, and custodian wallet providers, are registered […]”* (Council Directive 2018/843/EC), which again confirms that these kind of companies must be regulated under the local AML regulation. There is some additional guidance under Recital 8-11 and 16, but otherwise, the Directive is not clearer on what else national authorities have to come up with under national law.

Summarizing the above there has been some development around the regulation of virtual currencies under existing AML/CTF regulations. However, considering the still ongoing increase of new currencies, new providers of exchange services and also the development in the blockchain area, it can be

expected that there will be some additional need for clarification around AML/CTF obligations from a regulatory perspective.

6.3 Geopolitical Risks

The purpose of this section is to analyze the different type of risks or even weaknesses in the global fight against ML/TF. Some of the areas that we want to highlight are self-made problems by regulators around the world and others are caused through political influence that seems to impact the work that regulators are doing.

6.3.1 Data sharing

Please be informed that the focus of this section will be the data sharing between financial institutions and groups more specifically insurance groups and not the information sharing between the public sector and financial institutions or among public authorities.

The FATF in its guidance on Private Sector Information Sharing states that, *"[…] Effective information sharing is one of the cornerstones of a well-functioning AML/CFT framework […]"* (FATF, 2017b, p. 2) or *"[…] Multinational money laundering schemes do not respect national boundaries. Barriers to information sharing may negatively impact the effectiveness of AML/CFT efforts and conversely, inadvertently facilitate operations of such criminal networks […]"* (FATF, 2017b, p. 2). In addition to that FATF under Recommendation no. 18 says *"[...] Financial groups should be required to implement group wide programs against money laundering and terrorist financing, including policies and procedures for sharing information within the group for AML/CFT purposes […]"* (FATF, 2018a, p. 16 f.). To underline the importance of information sharing the FATF also amended its Recommendation no. 21, which now under letter (b) clarifies that *"[…] prohibited by law from disclosing ("tipping-off") the fact that a suspicious transaction report (STR) or related information is being filed with the FIU. These provisions are not intended to inhibit information sharing under Recommendation 18 […]"* (FATF, 2018a, p. 17).

Considering the above it seems to be quite clear that information sharing within a group of a global insurance company in scope of AML/CTF regulation should form a part of their AML/CTF framework. However, the reality is much more difficult than one would think. Although regulators such as the EU within the 4th and 5th AMLD Art. 39, which says *"[…] including procedures for sharing information within the group, in accordance with Article 45, and that the group-wide policies and procedures comply with the requirements set out in this Directive […]"* (Council Directive 2018/843/EC) or FINMA as part of its revised AMLO-FINMA as already discussed under section 2.2.3 of this thesis there are still several local data sharing restrictions in place that need to be overhauled to overcome this significant barrier to implement effective measures for the prevention of ML/TF. This issue was emphasized in a survey on Machine Learning in Anti-Money Laundering, which was run by the Institute of International Finance (IIF) in 2018 among 59 financial institutions (FIs). The survey was performed among 54 banks and 5 insurance companies which captured a wide geographical range covering every continent (IIF, 2018c, p. 5). IIF based on the survey said that *"[…] the current situation of increased barriers to information sharing and the continued uncertainty around the balance between AML/CFT requirements and privacy barriers puts financial institutions in an almost unacceptable position of having to choose which to follow […]" (IIF, 2018c, p. 63).* Therefore, IIF is pushing regulators globally that within the applicable AML/CTF laws and regulations it is stated that *"[…] it is permissible to share and process the information mentioned above (i.e. KYC information and monitoring results) among members of the same banking or insurance group to prevent financial crime, even if there is no suspicion about a customer […]" (IIF, 2018c, p. 64).* In addition, they highlight that it is important to have a consistent approach amongst the regulators to prevent ambiguities and regulatory fragmentation as much as possible. If this could be achieved FI would not only benefit from more clarity around intra-group information sharing but also would be able to

strengthen their internal AML/CTF frameworks, which in the end the financial system in general would benefit from.

6.3.2 Blacklisting (High-Risk Countries)

As already pointed out in Section 5 there are different ways and methodologies on how the FATF and the EU, based on Directive (EU) 2015/849 and the Commission's power of adopting delegated acts, come up with their respective high-risk third country lists. The current lists of the two actors, which is based on different methodologies, consist of the following countries. Whereas the EU's list is directly applicable to Member States under Art. 2 of the Delegated Regulation (EU) 2016/1675, Delegated Regulation (EU) 2018/105, Delegated Regulation (EU) 2018/212 and Delegated Regulation (EU) 2018/1467:

FATF high-risk and other monitored jurisdictions	EU high-risk third country list
Action plan in place to resolve the issues ("Grey List") • Bahamas *(not on EU's)* • Botswana *(not on EU's)* • Cambodia *(not on EU's)* • Ethiopia • Ghana *(not on EU's)* • Pakistan • Panama • Sri Lanka • Syria • Trinidad and Tobago • Tunisia • Yemen	• Afghanistan • Bosnia and Herzegovina • Democratic People's Republic of Korea • Ethiopia • Guyana • Iran • Iraq • Lao PDR • Pakistan • Sri Lanka • Syria • Trinidad and Tobago • Tunisia • Uganda
Counter-measures apply ("Black List")	

• Democratic People's Republic of Korea • Iran	• Vanuatu • Yemen

Table 7: High-risk country list as of 30.06.2019 (FATF, 2018c & Delegated Regulation (EU) 2016/1675))

Very high-level the FATF identifies the countries that land on their "high-risk and other monitored jurisdictions" list on the basis of adverse results in a mutual evaluation by the International Co-operation Review Group (ICRG)[17] (FATF, 2018c) and other criteria such as not participating in a mutual evaluation at all and finally puts them in two above mentioned buckets (FATF, 2019b). The EU Commission itself issued in June 2018 its new methodology for identifying high-risk third countries, which takes as a baseline the FATF list and on top includes additional countries based on the EU's own assessment, following a very detailed methodology (Commission, 2018a). After issuing this new methodology the EU Commission in February 2019 adopted its new list of 23 third countries with strategic deficiencies in their anti-money laundering and counter-terrorist financing frameworks (Commission, 2019c). Next step was to get the approval of the European Parliament and Council for within one month (with a possible one-month extension) and then once approved, the Delegated Regulation would have been published in the Official Journal and would have entered into force 20 days after its publication (Commission, 2019c). Same day of the publication of the Commission's list the U.S. Department of The Treasury (USDT) issued a public statement saying *"[…] The U.S. Department of the Treasury has significant concerns about the substance of the list and the flawed process by which it was developed […]"* or *"[…] The Treasury Department does not expect U.S financial institutions to take the European Commission's list into account in their AML/CFT policies and procedures [..]."* (USDT, 2019). The reason for this

[17] The four regional review Groups of FATF (Americas, Asia/Pacific, Europe, Africa/Middle East).

was that there were several U.S. Territories such as Puerto Rico or the U.S. Virgin Islands on the Commission's list. In addition, also Saudi Arabia was part of the high-risk country list and according to the Saudi Press Agency the Saudi government said that they regretted the decisions (Reuters, 2019). As a response to the political pressure the European Council mid-March 2019 rejected the Commission's high-risk country list so that they now need to present another list (EU Parliament, 2019). Considering the events above it seems clear that these assessments around high-risk countries with regards to ML/TF do not seem to be only objective based on clear and transparent predefined criteria but more so influenced by the political power-play by certain countries and or groups. Diplomatic pressure and lobbying seem to be the way how a country, if they have enough influence, stay away from such blacklists. Having this in mind one could ask what the value of those lists is and therefore, if it really makes sense to follow them as an FI, which does not have the obligation to follow one or the other list (e.g., an FI outside of the EU). Switzerland for instance took the approach according to the revised AMLO-FINMA, follow FATF's list but only considering the "Black List" for countries to which counter-measures apply. This seems to be a very limited number of countries (Democratic People's Republic of Korea and Iran) and therefore, a global insurance group based in Switzerland might consider applying a more conservative approach and take into account either the complete FATF list or a combined list of FATF and EU Commission list. This decision might be taken considering the insurance group's global footprint and consequently regulatory exposure.

6.4 FinTech & RegTech in Anti-Money Laundering

The aim of this section is not to explain in detail what FinTech or RegTech is or can do in general and how it developed over past decade. The author wants to provide a glance of what can be done with FinTech/RegTech for the prevention of ML/TF, with a focus on Artificial Intelligence and Machine Learning in the insurance industry, where the benefits and the challenges are and where the

regulators stand with regards to allowing or even pushing for certain initiatives in that field.

6.4.1 FinTech & RegTech in Practice

Although the interaction between finance and technology has a longstanding history, the term FinTech has only risen to prominence in the past years (Arner, Barberis & Buckley, 2017, p. 377). On the other hand RegTech developments are primarily a response to the huge costs of complying with new institutional demands by regulators and policy makers. Because of this increase in costs there is a strong economic incentive for more efficient reporting and compliance systems to better control risks and reduce compliance costs (Arner, Barberis & Buckley, 2017, p. 374 f.). It also seems clear that so far traditional financial institutions and their Risk Management and Compliance needs have been the primary driver for the market of RegTech solutions (Arner, Barberis & Buckley, 2017, p. 388). Main examples for this are the AML and know your customer (KYC) compliance requirements that further developed over the past years, as described in this thesis and because of this the majority of RegTech solutions to date have focused on KYC compliance (Arner, Barberis & Buckley, 2017, p. 392). This will also be analyzed in more detail on one specific example "Artificial Intelligence and Machine Learning" under section 6.4.2 of this thesis.

Not only but also because of that, the FATF launched its FinTech and RegTech initiative in 2017 where they also stated *"[…] The FATF strongly supports responsible financial innovation that is in line with the AML/CFT requirements found in the FATF Standards, and will continue to explore the opportunities that new financial and regulatory technologies may present for improving the effective implementation of AML/CFT measures […]" (FATF, 2019c).* So far the initiative by the FATF consisted of various industry roundtables (incl. participants from the FinTech and RegTech sectors, FIs and FATF members), where opportunities, challenges but also concrete examples such as digital identification

have been discussed. In addition, to help strike the right balance between supporting innovation and managing any ML/TF risks that arise in the framework they set out the following high level, guiding principles *(FATF, 2019c):*

- *Fight terrorism financing and money laundering as a common goal;*
- *Encourage public and private sector engagement;*
- *Pursue positive and responsible innovation;*
- *Set clear regulatory expectations and smart regulation which address risks as well as allow for innovation; and*
- *Fair and consistent regulation.*

However, nothing really concrete has been done by the FATF except from agreeing to explore he opportunities that new financial and regulatory technologies present for improving the effective implementation of AML/CFT measures. It might also be that there is nothing more to come from the FATF as the main objective is that with or without RegTech the Recommendations will be adhered to.

A good example where the Swiss Regulator FINMA followed exactly one of the guiding principles of the FATF (*Set clear regulatory expectations and smart regulation which address risks as well as allow for innovation)* is the publication of the revised "Video and online identification" circular (FINMA, 2018g). FINMA said that it *"[…] has amended the due diligence requirements for client onboarding via digital channels to take account of technological developments…"* (FINMA, 2018g). The purpose was to give clear instructions on the interpretation of the due diligence requirements of the AMLA and its implementing provisions on the digital provision of financial services.

Although there are not many other examples so far where regulators start to specifically address innovation within the financial services industry there seems to begin a rethinking also by the regulators. However, challenges that will remain also in the next years are most likely that regulators will not be able to come up with appropriate regulations before the industry did not develop or

launch new innovations. This means that in the authors view it will remain challenging for regulators to anticipate and create the right level of regulatory balance without knowing where the industry goes. Therefore, also in the field of AML/CTF regulation, regulators will most likely always run behind the trends and innovation.

6.4.2 Artificial Intelligence & Machine Learning in Anti-Money Laundering

"Machine learning is a method of data analysis that automates analytical model building. It is a branch of artificial intelligence based on the idea that systems can learn from data, identify patterns and make decisions with minimal human intervention" (SAS, 2019). It has already been discussed that RegTech developments are primarily a response to the huge costs of complying with new institutional demands by regulators and policy makers. In addition, new technological developments, such as artificial intelligence (AI) and machine learning, allow for improved forms of monitoring and reporting (Arner, Barberis & Buckley, 2017, p. 390). That is why the application of machine learning techniques in AML is increasing rapidly across the financial services industry (IIF, 2018c, p. 3). Before we discuss the challenges, which financial institutions (FI) encounter when applying machine learning, we briefly look into the key use cases for machine learning in AML. The four key areas according to the detailed survey report that the IIF published in October 2018 are (IIF, 2018c, p. 16 ff.):

- Transaction Monitoring
- Customer Segmentation
- Risk Modelling
- Know Your Customer use cases

Transaction Monitoring is the field where the range and number of use cases seems to be unlimited and therefore, what firms are focusing on most. The main area for unsupervised machine learning is Customer Segmentation. Companies use machine learning to segment either by business segment or they take

into account various predetermined factors such as type of customer and product, type of transactions, geographical risk, etc.. Under Risk Modelling FIs consider Customer Risk Scoring and Business risk modelling as the most important use cases. Both allow based on an algorithm to assess and assign a risk rating to a customer or to the overall exposure to money laundering across a FIs entire operation. The use cases in the area of KYC are more limited than others. However, also in this area machine learning can be applied in various beneficial ways such as to identify missing information during an onboarding process of a new customer or to process unstructured data (IIF, 2018c, p. 17 ff.).

The main benefits of applying machine learning according to the industry survey are i) an increased speed and/or automation of analysis that allows the AML process to respond to the latest development in ML methods and ii) a reduction of false positives (IIF, 2018c, p. 42 f.).

The main challenges or key problems that have been identified are data quality, IT-infrastructure related problems, such as incompatibility with new machine learning software and as already discussed in section 6.3.1 impediments to data sharing within a group (e.g., insurance group) (IIF, 2018c, p. 47 ff.).

As we have learned that the usage of machine learning and AI is spreading in the financial services industry and particularly in the area of prevention of financial crime (e.g., AML/CTF). The author does not expect that this trend in the next years will stop. However, the existing key pillars of the AML/CTF frameworks will remain mostly the same. Nevertheless, machine learning presents an opportunity to significantly enhance the effectiveness and efficiency of the existing measures to tackle certain risks. In addition, an increase of automation should also allow more flexibility as changing a specific criteria in an automated and connected framework should be much easier then amending and adjusting various manual processes and controls. One factor that is very important to further allow the increase in the application of machine learning and AI is the acceptance and collaboration of regulators around the world. As long as certain barriers or a lack of harmonization in specific fields of regulations exists, it will

remain a huge challenge to effectively and consistently apply these kind of techniques especially in a globally operating group. The same applies to a broader exchange of information between the public and the private sector, which allows to build a stronger framework to combat ML/TF on a global scale.

6.4.3 Data Analytics in Anti-Money Laundering

Same as AI and machine learning also data analytics should still be considered a new instrument to support AML/CTF frameworks. The key areas where FIs apply data analytics are the same as in machine learning (IIF, 2018c, p. 16 ff.) just with less automation compared to machine learning and AI. However, before being able to apply data analytics and benefit from the advantages that come with it, there are still a few steps to go through, which might be in some instances quite challenging. Key steps of the data analytics in the authors view, which is mostly aligned with the model IIF is mentioned in their survey report on machine learning (IIF, 2018c, p. 7ff.), are:

- **Definition of the risk:** Before trying to come up with a certain use case, which has to be programmed and implemented in existing core systems, it is important to understand and define which risk should be mitigated through a certain use case.
- **Definition of the use case that should mitigate the risk:** As a next step, based on the risk definition, one can start drafting the use case.
- **Data requirements:** Once the drafting of the use case is finalized, one needs to understand, which data points are required to perform such a use case.
- **Data collection:** Based on the list of data points and the mapping with the existing core systems, which contain the data required, one can start extracting the data and transform it in a format as needed to continue with the analysis of the data.
- **Data test:** Is the actual analysis based on the data collected and allows to come up with red flag cases.

- **Results validation and documentation/visualization:** Going through the cases highlighted as potentially red flags to ensure they really are issues and cannot be excluded based on a reasonable explanation (e.g., issue around data quality). As a final step one should be able to visualize the results in a way that also non subject matter experts easily understand the potential issues that have been discovered.

The most critical area that brings that could create the biggest challenges is most likely for many firms the data collection. This includes not only the need for being able to extract all the data needed to perform the tests but also the data quality (Balmer, 2019). Once the test are in place and running effectively the three key advantages in using analytics are in the authors view clearly the following:

- **Completeness:** 100% of the cases can be tested and not just a sample.
- **Efficiency:** Once set-up the data gathering and testing can be automated.
- **Fact based:** The results of data analytic tests reflect what is happening and which controls are effectively working.

In the authors view, all firms operating in the financial services industry nowadays should consider the usage of data analytics to strengthen their framework on AML/CTF. However, it is important to consider the additional need for resources and skills (Balmer, 2019), that is needed to set up the data tests in a way that they are providing the expected results and being able to process/analyze the results.

7 Summary and Conclusion

The aim of this thesis was to shed light on the most recent developments in anti-money laundering legislation in relation to the insurance sector in Switzerland, the European Union (EU) and globally. In addition, it should compare these different regulatory frameworks while flagging challenges in the interplay of those and highlight the importance of innovation in the field of AML/CTF to support the fight against ML/TF by further technological developments.

When observing and analyzing the past years it became clear that almost under any regulatory regime, e.g., in the EU or Switzerland there have been many developments and a dramatic increase of requirements in the field of AML/CTF legislation. The pace is extremely high in putting out new and higher standards and causes challenges to implement all these new requirements effectively and in time. In addition, globally operating companies still face challenges in terms of different requirements coming from different regulators (e.g., high-risk country lists). In some instances this is caused based on political power-play by certain countries and or groups, which definitively in this regulatory area is the wrong way to do so. This must change going forward to allow on the one hand and efficient fight against ML/TF, which should be the aim of every state and regulator and on the other hand reduce complexity and costs triggered thereof for firms that need to follow the different regulations.

The author assumes that reasons for the increasing pace in issuing new laws and regulations on AML/CTF must be the closer collaboration between regulators, although not yet there were it should be at one point, the increase in transparency in relation to beneficial owners (Balmer, 2019), a better understanding of money flows (e.g., through the automatic exchange of information for the purpose of tax compliance) and the increase in automated processes and controls to detect potential red-flags for ML/TF. All this allows regulators to better detect and understand potential weaknesses in the system and therefore, triggers another round of regulations including higher standards being issued.

Most likely the trend that will follow next is that regulators need to issue additional laws and regulations on AML/CTF, which cover and include the new way of doing business or payments. Either through new means of payments (e.g., virtual currencies) or new payment providers, which are no longer just the traditional banks but start-ups, which operate only through mobile solutions.

Nevertheless, also this aspect has its positive side. Because of the steadily increasing and more complex requirements, which firms have to implement to meet the standards that regulators set out, there is a huge incentive for companies operating in the FinTech/RegTech area to push for new and innovative solutions, which are able to support in an efficient way. Although, there is definitively a certain investment, both in terms of efforts and money, required by firms that want to integrate such solutions in the field of AML/CTF it seems obvious that this should allow for cost savings over time due to the reduced amount of workforce needed to ensure the operating effectiveness of various manual processes and controls.

One thing is certain, an end of the strengthening of the AML/CTF regulations in the coming years is not yet foreseeable and with this the increase in costs of any company operating in the financial services industry to cope with them but also the steadily increasing incentive in relation to the development of FinTech/RegTech solutions, which are able to implement standards in a more efficient way in terms of workforce needed and IT-costs, will continue to grow.

8 Appendix

8.1 Bibliography

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8.2 Other Appendices

8.2.1 List of Abbreviations

Abbreviation	Definition
AMLD	European Anti-Money Laundering Directive
4th AMLD	Fourth European Anti-Money Laundering Directive
5th AMLD	Fifth European Anti-Money Laundering Directive
AML	Anti-Money Laundering
AMLA	Anti-Money Laundering Act
AMLO-FINMA	FINMA Anti-Money Laundering Ordinance
Art.	Article
ATF	Anti-Terrorist Financing
BBI	Federal Gazette
CFT	Counter the Financing of Terrorism
CTF	Counter Terrorist Financing
CHF	Swiss Franc
EU	European Union
EBA	European Banking Authority
EDD	Enhanced Due Diligence
EIOPA	European Insurance and Occupational Pensions Authority

ESA	European Supervisory Authority
ESMA	European Securities and Markets Authority
FATF	Financial Action Task Force
FSRB	FATF-Style Regional Body
FI	Financial Institutions
FINMA	Swiss Financial Market Supervisory Authority FINMA
FINMASA	Financial Market Supervisory Act
FIU	Financial Intelligence Unit
ICO	Initial Coin Offering
ICRG	International Co-operation Review Group
IIF	Institute of International Finance
ML	Money Laundering
MROS	Money Laundering Reporting Office Switzerland
ParlA	Federal Act on Federal Assembly
Para.	Paragraph
PEP	Politically Exposed Person
R SRO-SIA	Regulation of the Self-Regulatory Organization of the Swiss Insurance Association
SCC	Swiss Criminal Code
SIA	Swiss Insurance Association
SR	Special Recommendations
SRO-SIA	Self-Regulatory Organization of the Swiss Insurance Association
TF	Terrorist Financing
TFEU	Treaty on the Functioning of the European Union

The Commis-sion	The European Commission
The Council	The European Council
The Court	The Court of Justice of the European Union
UN	United Nations
USD	US Dollar
USDT	U.S. Department of the Treasury.

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8.3 Additional documentation

8.3.1 Questionnaire

The following pages show the questionnaire that served as a guideline for the expert interview with the chair of the anti-money laundering working group of the Self-Regulatory Organization of the Swiss Insurance Association.

Questionnaire Master-Thesis: „Developments in Anti-Money Laundering Regulations for the Insurance Sector in Switzerland and the EU“

Name:

Function:

Company:

May your answers be quoted in this thesis?

YES ☐ NO ☐

1. Which are in your view the biggest challenges in relation to anti-money laundering regulation going forward?

2. Which are trends/innovations that you see most risky in terms of money laundering/terrorist financing?

3. Where do you see the biggest challenges for regulators in that regard (cf. question no. 2)?

4. Where do you see the biggest challenges for insurance companies in that regards (cf. question no. 2)?

5. How and when do regulators need to intervene (e.g., with regards to a new trend/innovation)?

6. Do you see other ways on how regulators should regulate/intervene?

7. How do you think will FinTech & RegTech in AML help/complicate the way insurance companies tackle the ML/TF risk?

8. How do you think will Data Analytics and Artificial Intelligence in AML help/complicate the way insurance companies tackle the ML/TF risk?

9. How to you see other challenges e.g., Data sharing restrictions black-listing (e.g., high-risk country lists)?

10. What is your view on most recent developments on AML/CTF regulations in Switzerland and the EU?

8.3.2 Resume

Sven Dobler was born on November 5, 1990 in Zurich, Switzerland. Since several years he is working as a Compliance Professional in the Legal & Compliance Department at Zurich Insurance Company Ltd (Zurich Insurance), the currently most valuable Swiss financial services company. After completing an apprenticeship at Zurich Insurance he held various positions in the Operations area but also in the Group Compliance Function. Besides that Sven Dobler holds a Bachelor of Science in Business Administration of the University of Applied Science Zurich. In his current role at Zurich Insurance he is responsible of developing and maintaining a robust, effective Compliance control framework across all businesses globally in respect of selected topics of the compliance risk universe such as Anti-Money Laundering and Customer Tax Compliance (FATCA, CRS and UK Corporate Tax Offenses).

Sven Dobler is currently enrolled in the Course XXIII of the Executive Master of European and International Business Law program 2018/2019 at the University of St.Gallen.