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INSURANCE — THE NEXT FRONTIER IN SANCTIONS ENFORCEMENT

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PERSPECTIVES

INSURANCE — THE NEXT FRONTIER IN SANCTIONS ENFORCEMENT

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On 6 August 2015, Navigators Insurance settled with the US Treasury's Office of Foreign Assets Control (OFAC) following allegations that the company violated multiple economic sanctions programmes. Its penalty – less than $275,000 – pales in comparison with the hundreds of millions OFAC has levied in its big bank cases. However, Navigators is an indication that OFAC is increasingly looking beyond banks to enforce violations in other industries – and the insurance sector could be at the top of that list.

OFAC's concentration on banking – present both in its formal blacklisting of financial institutions and its enforcement of sanctions violations against banks – was a logical tactic employed in support of an innovative sanctions strategy. It is the continuation of this strategy that most strongly points to insurance as a next front in enforcement.

Over the past decade, one of the most far-reaching advancements in sanctions practice has been governments' focus on restricting access for sanctioned parties to the often-unseen underpinnings of international trade (tools such as US dollar-clearing, correspondent accounts, trade finance, swaps, etc.) rather than on simply limiting physical trade in goods and services. Banks are the gatekeepers for many of these financial tools and companies, countries, and even individuals that are shut out of the formal banking system often lack access to these tools and quickly find cross-border

commerce at any significant scale untenable. This is a reality seen in Iran, Syria and even with respect to individual targets of sanctions. It is the power of these banking sanctions – and their importance to this still-nascent sanctions strategy – that helps explain OFAC's concentrated attention on the sector.

It is this strategy's success that has made OFAC's move beyond banking inevitable – the global finance sector is now keenly sensitised to sanctions and has 'de-risked' on a massive scale. Unsurprisingly, this has led to a decreasing number of substantial banking targets. As such, other industries, especially insurance, will come into focus. Insurance and finance, after all, share several key characteristics – most importantly, insurers are also foundational players in global commerce, serving in parallel roles to banks in providing critical tools that allow international trade to occur.

While an importer would not contract for goods without adequate financial cover – in the form of trade finance or guarantees – physical shipment of goods would not take place without sufficient insurance cover. The risks are too great: the likelihood of accidents at sea, in the air, on the road or in port is high and the necessary payouts with respect to injuries, destroyed goods and potential environmental damage are enormous. The risks are so vast that insurers themselves need to mitigate them, giving rise to the reinsurance industry, without which most primary insurance coverage could not exist. With no insurance or reinsurance, no real trade can occur. The necessity of access to insurance has been especially evident in the case of Iran where a combination of sanctions on Iranian insurers and Iranian ports made it impossible for shippers to be covered on calls to the country. Insurers were either unwilling to issue primary coverage for Iran voyages or unable to find reinsurance for those policies if they did.

Insurance's importance to trade is only part of its attraction for US authorities. The centrality of the US dollar to international commerce makes American banking sanctions especially potent – even without multilateral buy-in. Insurance has a similar US nexus.

Though many insurers are not located in the United States, the reinsurance market heavily relies on US assets. Without US funds the modern reinsurance market would not function efficiently and primary insurers may often be unable to mitigate their risks (and thus unwilling to write policies). As such, a US ban on insurance to specific targets – which has always included a ban on reinsurance of policies exposed to those targets – has often been enough to impede the issuance of insurance anywhere in the world to many sanctioned entities. Like their banking colleagues, insurers that provide services in circumvention of prohibitions can potentially greatly weaken the impact of these measures – and if discovered can consequently expect similarly harsh consequences.

Accordingly, the attraction of insurance for OFAC enforcement is similar to the agency's interest in the financial sector: it stems both from the potential impact of US regulations on the provision of insurance worldwide, and from the importance of making sure insurance sanctions are enforced robustly to further its strategy of denying instruments of international trade to sanctioned parties.

A separate factor pointing to increasing regulator interest is that the insurance industry suffers from some of the same challenges that led to several of the OFAC big bank cases. As in the finance sector, the breadth and scope of the insurance industry makes sanctions compliance at an industry-wide level challenging. Insurers come in a variety of sizes and sophistications, and as a sector insurance is exposed to almost every industry in nearly every country. Insurers face risks associated with unclear identity and beneficial ownership of policyholders and claimants, opaque corporate and legal structures, and government corruption. The fungible nature of insurance payouts – once more like finance – means that even insurers that carefully vet their customers may nonetheless see policyholder benefits accrue to parties that have not been approved.

"Even if there will be more OFAC actions implicating banks, the era of the multibillion dollar payouts of the big bank cases is likely behind us."

This situation is exacerbated by an uneven level of sanctions consciousness across the global insurance industry. In many respects the sector is in a similar position as the financial sector was prior to the first round of big bank cases in 2009. While, some sub-sectors have taken steps to inculcate sanctions awareness, large parts of the insurance industry have lagged. For instance, for the past several years many of the largest protection and indemnity providers (P&I Clubs) have deployed 'sanctions clauses' in policies (to render them void if a holder engages in sanctionable conduct) and rules changes that threaten the expulsion of members from Clubs if their vessels expose the Club to potential sanctions. However, it is telling that in the August 2015 Navigator's settlement OFAC explicitly faulted Navigators for being a "commercially sophisticated" enterprise and yet one without "a formal OFAC compliance program…." Even if insurers and reinsurers have started to develop and implement such programmes, they are several years behind their banking sector counterparts and there has not been a similar process of top-down, industry-wide sanctions sensitisation, let alone de-risking.

The Iran nuclear deal – the Joint Comprehensive Plan of Action – could further spur regulatory scrutiny of the sector. Once the initial round of sanctions relief materialises (likely in the first quarter of 2016), the European Union has committed to allowing insurance services to Iran, the Government of Iran, and Iranian entities. The United States, however, has only agreed to cease the application of its secondary sanctions on insurance – meaning that Europeans (and others) writing policies or selling reinsurance for Iran business will likely not face US repercussions for doing so. However, the primary prohibitions on US persons dealings with Iran will, on the whole, remain – including with respect to insurance. US insurers and reinsurers will likely not be able to issue or service policies with an Iran nexus nor will US banks be able to process payments for US dollar-denominated premiums or claims. It is not clear how the global insurance markets will function if they continue to have no access to the US system. At a minimum, the divergence between US and EU sanctions will complicate insurers' operations and make at least US regulators look even more closely at the industry to make sure remaining sanctions are enforced.

Even if there will be more OFAC actions implicating banks, the era of the multibillion dollar payouts of the big bank cases is likely behind us. Other targets will be increasingly on the mind of regulators in the United States and abroad. Insurance – for the all reasons it is like finance and distinct from it, and the central role the sector has in global commerce and will be called upon to play in reintegrating Iran into the world trading system – is an industry ripe for increased scrutiny and significant further enforcement actions. R&C

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