THE INSURANCE INDUSTRY AND OFAC ECONOMIC SANCTIONS

Vincent J. Vitkowsky
Partner, New York
VVitkowsky@eapdlaw.com
212.912.2828

Stephen G. Huggard
Partner, Boston
SHuggard@eapdlaw.com
617.239.0769

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Introduction

As the Treasury Department has stated, “OFAC programs are a frontline defense against foreign threats to our national safety, economy and security.”

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Strict Liability Regime

- Most OFAC programs are based on strict liability.
- This means that even unintentional violations may result in civil and criminal penalties.
- Penalties can be imposed not only on companies, but also on individuals involved in underwriting, administration and claims.

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2011 Insurance Industry Penalties

- OFAC has demonstrated an increased interest in the insurance industry, and in the last few months, penalties have been imposed in four cases.
- A Texas-based reinsurance broker facilitated the placement of coverage and payment of premiums for a facultative retrocession reinsurance agreement, entirely among Europeans, covering the construction risks of a petroleum project on Kharg Island in Iran. The firm paid $36,000.
- A US insurance broker placed six commercial multiple peril insurance policies that insured the risks of a submersible oil rig in Iranian waters. The firm paid $122,408 The fine was mitigated by the facts that senior management was unaware of the actions that led to the violations and that the broker had subsequently strengthened its OFAC compliance program in response to the violations.

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2011 Insurance Industry Penalties *(cont.)*

- A life insurance company mailed a death benefit check for $30,162 directly to the beneficiary in Cuba. The matter was not voluntarily disclosed to OFAC but was reported to OFAC and the insurer by the US decedent's attorney. The insurer was fined $22,500. The base penalty for the company's violation was reduced by the fact that it had not been subject to prior OFAC penalties and cooperated with OFAC. In addition, the insurer had taken steps since the incident to enhance its OFAC compliance program.

- An insurance company was sanctioned for participating in the hull portion of an aircraft hull and liability insurance policy that covered commercial flight operations in Iran from April 2005-April 2006. The policy insured a foreign-owned commercial airline that leased aircraft to an Iranian air charter company. The insurer paid $38,448, which was lower than the amount in OFAC's Enforcement Guidelines, because it was found to be non-egregious and there was voluntary self-disclosure.

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Authority for the OFAC Regime

- The President's War Powers
- Executive Orders
- From Congress, which has enacted the following statutes:
  - The International Emergency Economic Powers Act
  - The Antiterrorism and Effective Death Penalty Act
  - The Comprehensive Iran Sanctions, Accountability, and Divestment Act.
  - The Trading with the Enemy Act
  - The Cuban Democracy Act
  - The Cuban Liberty and Democratic Solidarity Act
  - The Iraqi Sanctions Act
  - The International Security and Development Cooperation Act
  - The Foreign Narcotics Kingpin Designation Act
  - The United Nations Participation Act

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OFAC Economic Sanctions and Embargo Programs

OFAC administers over 20 separate programs directed at nations and activities. Sixteen of these programs are directed at the following nations:

- Balkans
- Belarus
- Burma (Myanmar)
- Cote d'Ivoire
- Cuba
- Congo
- Iran
- Iraq
- Lebanon
- Liberia
- Libya
- North Korea
- Sudan
- Syria
- Somalia
- Zimbabwe

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Activity Based Programs

Five of these programs are directed at the following activities:

- Global Terrorism
- Non-Proliferation of Weapons of Mass Destruction
- Diamond Trading
- Kingpin Narcotics
- Narcotics Trafficking

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Each Program Is Different

- The specific restrictions and penalties vary for each of the different OFAC programs. Thus, the facts of a particular transaction must be carefully scrutinized in the context of the specific program, and the operation of the various programs can be described only in general terms.

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The 2011 Libya Program

- President Obama issued Executive Order 13566 on February 25, 2011
- Applies to:
  - Muammar Qadhafi, his children, their spouses and dependents
  - Any senior official of the Government of Libya, their spouses and dependents
  - Anyone participating in the human rights abuses relating to political oppression in Libya, and
  - Anyone materially assisting those participating in such human rights abuses (and spouses and dependents)

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The 2011 Libya Program

- The Executive Order blocks the property of these persons.
- Blocked property may not be transferred, paid, exported, withdrawn or otherwise dealt in.
- Press reports indicate that many of these persons have lived outside of Libya.
- They might well have purchased various forms of insurance. The payment of claims and the receipt of premiums are likely prohibited by these sanctions.

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The 2010 Iran Program

- The Comprehensive Iran Sanctions, Accountability, and Divestment Act regime is even more comprehensive than the others.
- It extends sanctions to the non-US insurers and non-US ship owners who provide insurance or transportation services for certain trade with Iran, notably in the petroleum industry.
- This program:
  - requires knowing violations
  - provides a safe harbor for companies that establish compliance policies and procedures

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The EU Regime

- The EU has its own sanctions regime. The United Nations Security Council occasionally issues Resolutions imposing economic sanctions and embargos, which are implemented in EU countries through national legislation or EU Regulations.
- Sanctions implemented by the EU apply to all persons and companies doing business in the EU, and EU nationals and entities doing business outside the EU. Penalties vary among the member states. In the UK, violations are typically criminal offences.
- One of the special challenges in this area is the existence of an EU Council regulation "blocking statute," which makes it illegal for any EU company to comply with certain specified US sanctions, either actively or by omission .

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Who Are the OFAC Targets?

- The broadest restrictions relate to Cuba, and apply governmental entities and officials, companies located in Cuba, companies organized or controlled from Cuba (wherever located), and individuals residing in Cuba, regardless of their citizenship, and Cuban citizens based on their citizenship alone.

- The complete list of OFAC Targets is far more extensive. There are about 6,000 companies, organizations, individuals and vessels on OFAC's "Specially Designated Nationals and Blocked Persons List" (the "SDN List"). That list is continually updated, on no specific timetable or schedule, but instead as circumstances warrant

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Overview of OFAC Restrictions Applicable to Insurance Industry

- Broadly, OFAC prohibits companies and individuals from issuing insurance policies and reinsurance contracts involving nations, companies, organizations, individuals or vessels subject to a sanctions program.
- In some programs, OFAC also prohibits actions approving, guaranteeing, financing or facilitating transactions involving OFAC Targets.
- OFAC requires that any funds in which an OFAC Target has a direct or indirect interest must be "blocked," *i.e.*, deposited into a US bank in a separate interest bearing account, and a report must be filed within 10 days.
- Claims cannot be adjusted or paid.
- Exemptions or exceptions can be made only by obtaining a license from OFAC .

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Who Must Comply?

- Each program is different. Most apply to "US persons," some to "Persons Subject to the Jurisdiction of the United States," some to importers and exporters into and from the US, and some to all persons who possess certain items.
- "US persons" include insurers, reinsurers, agencies, brokers, reinsurance intermediaries, third-party administrators, and their employees.
- They also include the overseas branches of US companies, but not overseas subsidiaries (except in the cases of Cuba and North Korea, where the restrictions include any entity owned or controlled by US persons).
- Individuals who are US citizens or permanent residents must comply, wherever they are located, and whoever they work for.
- Anyone who is physically present in the U.S must also comply.
- Non-US persons outside the US may be prosecuted for conspiracy with a US person.

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Penalties

- Penalties can be civil or criminal, and vary depending on the program and statutes involved. When a violation comes to its attention, OFAC has five options:
  - take no action
  - send a cautionary letter
  - find a violation.
  - impose a civil penalty.
  - refer the matter for criminal prosecution.
- For most transactions, civil penalties can range from one-half of the transaction value (with a $125,000 cap) to much higher amounts. The value of the transaction is typically measured by the amount of premium or the amount of a claim payment.

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Penalties *(cont.)*

- The penalty amounts are assessed for each violation, so a single policy could result in multiple violations, occurring at, for example, policy issuance, subsequent receipt of premium, and payment of a loss.
- Penalties can be increased by aggregating the amounts due under multiple applicable statutes.
- There are also penalties for failing to file reports on time.
- Criminal penalties may also be imposed, with fines as high as $10 million and prison terms of up to 30 years.
- Criminal referrals are made when the violation is intentional, resulting from a deliberate corporate policy, with the knowledge of senior management.

Mitigating Factors

- Whether the case was egregious, which will raise the amount
- Whether the violation was discovered by voluntary self-disclosure (which will tend toward mitigation, sometimes by as much as 50%)
- The existence of a compliance program is also an important consideration in favor of mitigation
- The government increasingly wants to see meaningful compliance programs – not just manuals that are largely unread

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Violations in the Insurance Industry

- It is a violation to issue a policy, engage in a transaction (including receipt of premiums and payment of claims), or facilitate a transaction with an OFAC Target.
- Challenges arise because OFAC Targets can appear in transactions in various ways, such as insureds and additional insureds, policyholders, payers of premium, beneficiaries, loss payees, intermediaries and administrators of all variety, banks as lien holders, banks to which premiums and claims payments are deposited or routed, or even third-party liability claimants.

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Examples from OFAC

OFAC has provided the following examples of transactions which would be prohibited or blocked:

- An aviation policy, issued to a nonblocked foreign airline, which names a Bank which is an SDN as an additional insured because the bank holds a mortgage on the aircraft;
- A liability policy covering the pharmaceutical operations of a company in Columbia, which has been named as a Specially Designated Narcotics Trafficker;
- A reinsurance contract for policies underwritten in whole or in part by an insurer which is an SDN;
- A property insurance policy written for an international hotel chain which covers hotels in Iran;

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Examples from OFAC *(cont.)*

- A marine cargo or “goods in transit” policy insuring a shipment of Iranian or Sudanese crude oil shipped from Egyptian ports to a Spanish buyer;
- An aviation liability policy known to cover scheduled stops in Cuba by a foreign air carrier;
- A liability policy covering a private oil exploration company's operations in a sanctioned country; and
- Return of a premium overpayment to a Cuban resident in France.

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Examples from OFAC *(cont.)*

OFAC has also indicated it is impermissible to insure transactions such as:

- Unlicensed imports and exports of goods and services to and from, and commercial activity in, Iran, Sudan, and Cuba;
- Unlicensed shipments of Iranian, Sudanese, or Cuban origin goods, or goods in which the government of Libya has an interest (such as Libyan crude oil);
- Imports of uncertified diamonds, or any imports of diamonds from Liberia; and
- Imports of goods, technology, or services produced or provided by foreign persons designated by the Secretary of State who promote proliferation of weapons of mass destruction.

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Avoiding Violations

- Declinations and Exclusions
- In OFAC's view, a company cannot issue a global insurance policy without an OFAC exclusion.
- If an OFAC exclusion is not commercially feasible, an insurer must apply for a specific license to write the risk.
- OFAC has identified the following exclusionary language for open marine cargo policies:

  " whenever coverage provided by this policy would be in violation of US economic or trade sanctions, such coverage shall be null and void."

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Establish OFAC Policies and Procedures

- Although there is no requirement that companies establish a compliance program, every company should consider establishing some OFAC Policies and Procedures, with variations based on the specific nature and scope of its business.

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Screening

- The first step is to create a system to check the SDN List whenever:
  - an application is received
  - a request to change an insured, owner or beneficiary, or to add an additional insured, loss payee, or lien holder is received
  - a claim is presented, and
  - a claim payment is made, including one requiring a deposit in or a transfer through a bank.
- These requirements are ongoing. That is, if a policy is issued at a time when none of the relevant entities are OFAC Targets, but that changes after issuance, all transactions must cease, and a report must be filed.

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Screening *(cont.)*

- If an apparent match is found, it is necessary to determine whether it is accurate, or a “false positive.” This requires human research and analysis.
- If the hit proves to be accurate, OFAC must be notified, even if the risk is declined.
- The customer should be notified only in the ordinary course of business, and OFAC has approved language for this purpose.
- In some states, the state’s insurance department must also be notified.

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Screening *(cont.)*

- OFAC regulations preempt any conflicting state insurance regulations relating to declinations, cancellations, or failing to make claims payments .
- To assist in screening, most companies utilize OFAC compliance software, sometimes known as “interdiction” software.

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Lines Most Affected

- Large commercial property and casualty insurance of multinational corporations or non-US corporations
- Pooling arrangements covering international risks
- Ocean marine, aviation and other transportation policies
- Travel insurance, including policies to third-country nationals who travel to OFAC Target countries
- Crisis covers like political risk, contract frustration and KRE
- Group life and health policies covering expatriots

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Appoint a Compliance Officer

- In its Policies and Procedures, the company should appoint a specific person to be the OFAC Compliance Officer, and specific roles and responsibilities should be assigned to persons in IT and other key areas.
- OFAC Policies and Procedures should be written and approved by senior management, and distributed throughout the company.
- There should be internal training of all relevant personnel.
- Periodic internal audits should be conducted.

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Licenses

- An insurer may seek approval to engage in a transaction by requesting a license from OFAC. Even if the license is granted, to engage in other transactions under the policy and to pay claims, a separate license may be required.
- There is no “typical” time period for approval.

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What Claims Executives Need to Know

- Payments cannot be made to, or through, an OFAC Target.
  - Nor can payments be made “indirectly” to OFAC Targets.
- Potential payees, including third-party liability claimants, should be checked against the SDN List.
- Special attention should be given to claims having any connection with OFAC Target nations or activities.
- If a search of the SDN List identifies that a confirmed OFAC Target has an interest in a claim, a report must be filed with OFAC within ten days.

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What Claims Executives Need to Know *(cont.)*

- Insurers may not pay amounts for damage mitigation or prevention. They may not issue security or bonds for the release of arrested vessels. They may not evaluate and adjust claims. (This includes services by a US person who is a claims adjuster providing services to a foreign insurer.) They may not defend an insured. They may not pay claims or reimburse an insured party.
- Any claim payments due to an OFAC Target, or due to be deposited to or transferred through a bank which is an OFAC Target, must be stopped before they are made.
- The claimant should be notified in the normal course of business.

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Responding to Subpoenas and Potential Enforcement Actions

- If you receive a subpoena, it may well be for a transaction that occurred one or more years ago.
- You will have to certify the completeness of your response.
- The subpoena process will allow you to submit a written explanation for the transaction.
- You need to understand your facts before you respond to the subpoena.
- The subpoena will probably require you to produce any evidence of a compliance program.

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Responding to Subpoenas and Potential Enforcement Actions

- Communications with the investigator can help you to determine the tenor of the investigation and supplement your written response.
- This process allows you to not only produce the required documents, but also lay the foundation for your belief why a violation has not occurred, or if it did, why it is not egregious.

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Claims Against Insureds

- In recent years, there have been several high profile enforcement actions involving financial institutions. These involved non-US banks which have been fined for allegedly designing and using processes to deliberately disguise transactions to avoid OFAC restrictions.
- One bank paid $536 million for allegedly deliberately concealing the identity of OFAC Targets related to Sudan, Cuba, Libya, Myanmar and the former regime in Liberia.
- Another bank paid $350 million for allegedly concealing transactions that had the effect of supporting the governments of Iran and Sudan, and Libyan interests.
- A third bank paid $298 million for allegedly facilitating illegal payments to Iran, Cuba, Libya, Sudan and Myanmar.

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Claims Against Insureds *(cont.)*

- Another bank paid $80 million.
- Yet another bank paid $5.75 million.
- Companies have also been prosecuted and fined for payments in other contexts, such as the Colombian Civil War.

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