

THE EFFECT OF CISADA AND OFAC REGULATIONS UPON U.S. INSURERS ENGAGED IN GLOBAL TRANSACTIONS

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Although the United States has had sanctions against Iran in effect since 1996, on July 1, 2010, the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA) took effect. As a result of the enactment of CISADA, U.S. insurers engaged in foreign transactions must now conduct an even closer review of new business opportunities or risk the imposition of penalties by the U.S. Office of Foreign Assets Control (OFAC).

OFAC promulgated the Iranian Financial Sanctions Regulations on August 16, 2010 to implement certain provisions of CISADA. The regulations prohibit, or restrict, U.S. financial institutions from maintaining U.S. correspondent accounts or payable-through accounts for foreign financial institutions that knowingly engage in any of the following acts: (1) facilitates the efforts of the Government of Iran to acquire or develop weapons of mass destruction; (2) facilitates the activities of a person subject to financial sanctions pursuant to U.N. Security Council Resolutions with respect to Iran; (3) engages in money laundering, or facilitating efforts by the Central Bank of Iran or any other Iranian financial institution, to carry out the activities in (1) or (2); or (4) facilitates a significant transaction or transactions or provides significant financial services for Iran's Islamic Revolutionary Guard Corps (IRGC) or any of its agents or affiliates whose property or interests in property are blocked pursuant to the International Emergency Economic Powers Act (IEEPA) or a financial institution whose property or interests in property are blocked pursuant to IEEPA in connection with the Government of Iran's proliferation of WMD or support for international terrorism.

OFAC's mission is to administer and enforce economic and trade sanctions based on U.S. foreign policy and national security goals against selected targets, including the provisions of CISADA. As of October 2010, the OFAC had twenty (20) active sanctions programs. The sanction programs fall generally into three (3) categories: (1) country-based programs (Iran, Cuba, Sudan); (2) Regime-based programs (Burma, North Korea, Zimbabwe); and (3) List-based programs (Narcotics trafficking, anti-terrorism, WMD proliferation). If a U.S.-based entity is found to have violated an OFAC sanction, the U.S. entity may be subject to varying degrees of enforcement actions, listed from least to most severe: (1) no action; (2) cautionary letter; (3) finding of a violation; (4) Civil penalty (up to a statutory maximum per transaction of \$250,000 or twice the transaction value); and (5) criminal referral to the Department of Justice (including penalties for willful violations of up to \$1 million and 20 years in prison). However, if an entity finds that it may become involved in a potential violation, the entity can apply to the OFAC for a license to engage in the transaction.

In light of CISADA, insurers must now determine whether any of their subsidiaries or affiliates are subject to CISADA, and also whether the business that they accept could be

involved in a prohibited transaction with Iran. To assist insurers in making these determinations, OFAC explained in a September 7, 2010 Guidance entitled, “What You Need To Know About U.S. Economic Sanctions”:

No. U.S. person may approve or facilitate the entry into or performance of transactions or contracts with Iran by a foreign subsidiary of a U.S. firm that the U.S. person is precluded from performing directly. Similarly, no U.S. person may facilitate such transactions by unaffiliated foreign persons.

It should be noted that CISADA specifically includes insurers, underwriters, guarantors, financial institutions, and any other business organization including foreign subsidiaries, parents or affiliates within its definition of “person.”

This guidance clearly prohibits foreign subsidiaries of U.S. insurers from entering into insurance contracts that would be considered violations of the sanctions. In addition, it could be argued that U.S. insurers that support foreign affiliates could be subject to these prohibitions, even though the foreign affiliate may not be considered a “subsidiary.” For example, even though they are not U.S. entities per se, Lloyd’s of London immediately recognized the impact of CISADA, and as of July 14, 2010, they no longer provide cover to owners of ships taking refined petroleum products to Iran.

In addition to determining whether CISADA applies to specific affiliated entities, an insurer must also determine whether a potential transaction could violate the sanctions. As explained above, certain transactions, when deemed “significant,” are prohibited. For example, in determining whether a transaction or financial service with the IRGC or its agents or affiliates is “significant,” OFAC may consider a number of factors related to the transactions or services, including, but not limited to: their size, number and frequency; their type, complexity or commercial purpose; whether they are performed with the involvement or approval of management; whether they are a part of a pattern of conduct or a business development strategy; how economically significant the transactions were for the parties involved; and whether they involve the use of deceptive financial practices.

Prior to the passage of CISADA, in November 2007, OFAC provided guidance to insurers who transact business in the global economy. Initially, OFAC suggested that if a U.S. insurer plans to issue a global insurance policy, it should include the following exclusion: “Whenever coverage provided by this policy would be in violation of any U.S. economic or trade sanctions, such coverage shall be null and void.” According to OFAC, the legal effect of this exclusion is to prevent the extension of prohibited insurance to sanctioned countries, entities or individuals. It essentially shifts the risk of loss for the underlying transaction back to the insured - the person more likely to have direct control over the economic activity giving rise to the contact with a sanctioned country, entity or individual.

The OFAC guidance also acknowledged that there might be a case where the recommended exclusion is not “commercially feasible.” In this case, OFAC recommends

that the insurer should apply for a specific OFAC license for the global insurance policy. In making a licensing determination, OFAC will review the facts and circumstances of each global insurance policy, including both risk frequency and risk severity, to assure that issuance of the policy will not undermine U.S. foreign policy goals. A separate license would be required for the insurer to pay claims arising under any authorized global insurance policy. However, in light of CISADA's provisions and OFAC's guidance on entering into transactions or contracts with Iran, it is doubtful that OFAC would issue a license if the transaction would clearly violate the U.S. imposed sanctions.

In conclusion, insurers and underwriters involved in global commerce must take measures to determine whether new business would act to violate the sanctions under CISADA and the OFAC regulations. This can be a fact intensive and time consuming analysis, but it is crucial to ensuring that insurers do not leave themselves open to penalties from OFAC. If after conducting such a review the insurance entity believes that a new insurance policy could potentially involve a prohibited transaction relating to Iran, the insurance entity should consider the following actions: (1) avoid the risk in the first place and do not write the policy; (2) utilize the OFAC-recommended exclusion; (3) upon identification of a potential violation, but before accepting the risk, request a license to engage in the transaction from OFAC; or (4) respond quickly to an apparent violation discovered after the issuance of the policy. Regardless of the action taken, the most important step an insurer can take is to establish appropriate internal controls to identify potential violations of the U.S. sanctions prior to entering into a transaction.

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