WEST

Notices to Members

No. 3 2016/2017 - Iran Trading – P&I Cover Update

March 2016

Introduction

Members are referred to Notice to Members No.2 2016/2017 concerning Iran sanctions. This Notice is intended to update Members on the latest developments in relation to the interim and longer-term solutions to the reinsurance recovery shortfall risk under the Group General Excess Loss reinsurance programme and Hydra retrocession programme.

1. Discussions with the US Administration.

Since the formal implementation on 16 January 2016 of the Joint Comprehensive Plan of Action (JCPOA) agreed between the P5+1 countries and Iran, the Group has been continuing its engagement with the relevant departments within the US government (the State Department and the Treasury Department's Office of Foreign Assets Control (OFAC)) to discuss the P&I insurance ramifications of the implementation of the JCPOA.

The implementation of the JCPOA in January 2016 resulted in the lifting of:

a. the nuclear-related EU sanctions which had impacted Iran trade and the insurance thereof (with the exception of some continuing prohibited trades and trading by, and with, SDNs), and
b. the nuclear-related US secondary sanctions, which impacted non-US person insurers/reinsurers.

However, the US administration did not undertake under the JCPOA to lift, nor has it lifted, the primary US sanctions which prohibit the provision of insurance/reinsurance cover by US-domiciled reinsurers.

2. Insurance cover solutions

In its discussions with the US Administration, the Group has maintained its primary contention that it is in the policy interests of the US government that US-domiciled reinsurers should be licenced to participate on the Group and Hydra reinsurance programmes. Over the next several months, the Group will be continuing its engagement with the Administration on this issue with the objective of securing a formal licence to allow such participation. Such a licence will be the most effective long-term solution to the problem of ensuring the availability of full, global, P&I coverage for shipowners. The proposed licensing solution does, however, raise fundamental policy questions for the US Administration and, as a result, licensing is unlikely to offer a "quick fix" to Clubs' short-term abilities to offer adequate, sustainable and effective insurance cover for their Members in relation to liabilities involving Iranian interests howsoever, or wheresoever, these might be incurred. Depending on the outcome of those discussions, the Group will, for the next policy year, also review the on-going participation of US-domiciled reinsurers in the Group and Hydra reinsurance arrangements.

In the meantime, and as previously advised to Members, in an effort to find an interim solution to facilitate a resumption of lawful trading with Iran, the Group has, with the assistance of its brokers, been investigating the possibility of placing a "fall-back" reinsurance programme. This programme is designed to respond to reinsurance recovery shortfalls resulting from the inability of US-domiciled reinsurers on the Group GXL and Hydra reinsurance programmes to make payments due to the continuing application of US primary sanctions. Subscription to such a programme would necessarily be confined to non-US reinsurers. The major concern of those reinsurers which have been approached has been a fear that participation

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in such a programme would be deemed by the US as unlawful “facilitation,” or a deliberate circumvention of US primary sanctions, or give rise to reputational issues.

Following extensive engagement with OFAC, the Group was successful in obtaining confirmation/comfort for non-US reinsurers potentially interested in participating on such a programme. Following further engagement by the Group’s brokers, the “fall-back” programme has now been put in place.

3. “Fall-back” cover - key features

The cover is an annual cover in respect of P & I liabilities, whether or not these arise under approved certificates or guarantees. It provides indemnity in respect of claims which would otherwise have been recoverable under the first and second layers of the Group GXL reinsurance programme, US domiciled private placement and the Hydra reinsurance programme, but for an inability to pay by US domiciled reinsurers by virtue of continuing US primary sanctions.

Importantly, there is a cover limit of €70 million in respect of any one event, and in the annual aggregate, with one full reinstatement. This limit would, at current exchange rates, accommodate a single vessel loss scenario based on a combined single event liability of US $500 million within the first layer of the GXL, the US domiciled private placement and the Hydra reinsurance. It would also be sufficient to respond to a single event certified (full CLC, WRC and TOPIA) exposure. In the absence of exhaustion through a single vessel loss scenario, the cover would be available to respond to a series of smaller loss events up to the €70 million aggregate limit. The largest historical loss to the GXL and Hydra reinsurance programmes involving Iran-related liabilities could have produced an exposure to the fall-back cover of up to approximately €20 million (assuming on a worst-case basis the Hydra AAD had already been fully exhausted). The Group’s brokers believe that capacity may become available further to increase the cover and reinstatement limits, and they will continue to investigate this possibility.

A key feature of the fall-back cover is that it not only provides reinsurance protection for a failure in reinsurance in relation to certified liabilities (arising under approved certificates e.g. Blue Cards and guarantees) which currently are poolable between Clubs without reinsurance under the Group Supplemental Pooling Agreement, but it also provides reinsurance protection in respect of other non-certified liabilities (e.g. collision, damage to property, etc.) in respect of which the risk currently rests with Members. In respect of such liabilities, as part of the “fall-back” solution, it has been agreed to pool these, to the full extent of Club cover, but only on the basis that the " fall-back” cover is available/has not been exhausted.

However, because of the cover limit, and the single reinstatement terms (in contrast to the GXL programme which has unlimited reinstatements), there is a risk that the cover could be exhausted by several very significant Iran-related liability claims, or an aggregation of smaller claims up to the overall current policy limit of €140 million (2 x €70 million). Consequently, the cover is not a “like for like” replacement of the cover currently available under the Group GXL and Hydra reinsurance programmes.

The Clubs have agreed to review this arrangement should it become apparent that the cover may be exhausted, or should it become unavailable for some other reason, for example the imposition of new sanctions or prohibitions. The fall-back cover itself contains a sanctions clause which could be engaged in the event of future sanctions or prohibitions constraining the subscribing reinsurers.

The Group will continue to explore possibilities for increasing the limit/re-instatement options for the cover to maximise the protection available for Members. This fall-back solution is, however, only a temporary one, due principally to the cover and reinstatement limits, even if they are expanded. Efforts and engagement will continue with the US administration with a view to ensuring that a permanent long-term solution is in place for 2017 at the latest.

All Clubs in the international Group have issued a similar circular.

Yours faithfully
For: **West of England Insurance Services (Luxembourg) S.A.**

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(As Managers)

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