Notices to Members

No. 7 2011/2012 - Iran Sanctions Update

March 2011

Translations: Vietnamese

Dear Sirs,

Iran Sanctions Update

We last updated Members on 12 October. There have been a number of significant developments since then, which are outlined here in more detail than in earlier reports. Members have been seeking the Club's advice in relation to sanctions legislation and are encouraged to continue to do so. Because of the very broad scope of the legislation and particularly The Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, HR 2194 (CISADA), such advice can only be given in general terms about the degree of risk of sanctions being imposed under CISADA as the Club sees it. It is not a substitute for detailed legal advice.

US Sanctions

The US Government did not publish regulations under CISADA by the end of September 2010 as originally intended, but the US State Department has recently published informal guidance on how it plans to implement CISADA. The full text of the guidance can be found in the attached link. It does not aim to be a definitive interpretation of CISADA and makes it clear that the State Department will consider each case of sanctionable activity on its own facts. The guidance is however helpful in indicating the US Administration's broad thinking on CISADA and that the focus of the sanctions remains on the import of refined products and goods used to maintain or expand Iran's refineries.

There is a comment in the guidance which suggests that providing insurance where the premium is less than $1 million may not be a sanctionable activity. The International Group Clubs are seeking clarification of the State Department's observation, given that for most vessels the estimated total call payable per entered vessel is likely to be less than that figure.

However, even if the provision of the Club cover were, on this basis, to be outside the scope of CISADA, that does not mean that the underlying trade of an insured vessel would necessarily fall outside the scope of the legislation and a Member may be exposed to sanctions even if the Club were not.

Nothwithstanding this general guidance from the State Department, Members intending to trade vessels to or from Iran or to do business in or with Iran need to consider on each occasion the risk of sanctions being applied under CISADA's very broad provisions and to seek appropriate advice on the legislation before doing so.

In addition to considering the impact of CISADA, Members also need to consider US legislation in respect of Specially Designated Nationals (SDN's) whose details are maintained in a list kept by the US Office of Foreign Assets Control (OFAC). In broad terms US legislation prohibits US persons and companies from doing business with SDN's, but non US persons and companies doing business with SDN's may attract the attention of the US Administration particularly in the context of CISADA. The SDN list includes not only individuals and companies but also ships. It is advisable for Members to

check the SDN list before doing business with individuals or companies or chartering vessels where there may be an Iranian interest and to take legal advice as to the implications of doing such business. The list is regularly updated by the OFAC and can be found at Specially Designated Nationals And Blocked Persons List (SDN) Human Readable Lists.

European Union

New EU sanctions under Council Regulation 961/2010 came into force on 27 October 2010.

The new EU sanctions affect the financial, insurance and transport sectors, and entities connected with the Iranian government and the Iranian nuclear industry. The sanctions apply in all EU Member States. The EU Regulation prohibits the provision of insurance or reinsurance to the Government of Iran, an Iranian person, entity or body and to any natural person or legal person acting on behalf of or at the direction of an Iranian person. The UK Treasury considers that this prohibition will also apply to reinsurance provided by an EU insurer where the underlying insured is an Iranian company, regardless of where the insurer is based. The prohibition has exceptions including the provision of compulsory or third party insurance to Iranian persons or entities based in the EU, insurance or reinsurance to Iranian individuals acting in their private capacity (except if they are on the EU list of specially designated persons or entities) and insurance or reinsurance to the owner of a vessel, aircraft or vehicle chartered by the Iranian Government or an Iranian person or entity. Renewal or extension after 27 October 2010 of insurance contracts made before 27 October 2010 is also prohibited as is participation in any activities intended to circumvent this prohibition, knowingly or intentionally.

The Regulation prohibits the sale, transfer or supply to Iran of dual-use goods and technology as well as equipment which might be used for internal repression. It also imposes restrictions on trade in key equipment and technology which could contribute to nuclear enrichment or reprocessing or heavy water related activities, or to the development of nuclear weapons systems. The prohibited items are listed in Annexes I, II, III and IV of the Regulation. Arms and all other related material and goods and technology listed in the Common Military List are also prohibited. Export to Iran of such goods or resources whether or not originating in the EU is subject to prior authorisation by the exporting Member State identified in Annex V of the EU Regulation. Technical assistance, brokering services, financing or financial assistance (including grants, loans and export credit insurance) in respect of the provision of the banned items to Iran is also prohibited. In addition there is a prohibition on imports and transport from Iran of the banned products listed in Annexes I, II and III of the EU Regulation.

Selling, supplying or transferring key equipment or technology to Iran for the production and exploration of crude oil and natural gas, refining and liquefaction of natural gas is prohibited together with technical assistance or training, or financing or financial assistance in respect of such equipment or technology.

Purchasing Iranian oil and gas appears not to be prohibited. The Regulation states that its measures “should not affect the import or export of oil or gas to and from Iran, including the fulfilment of payment obligations in connection with such import or export".

Unless authorised by the authorities of the relevant EU state, grants, financial assistance and concessional loans to Iranian persons or entities, the acquisition or extension of or participation in or the creation of a joint venture with an Iranian person or entity are prohibited. The prohibition applies to Iranian natural persons or entities related to the manufacture of military goods or technology, manufacture of equipment used for internal repression and exploration of crude oil, natural gas, refining of fuels or the liquefaction of natural gas. This prohibition also applies to uranium mining, uranium enrichment and reprocessing and the manufacture of goods and technology related to the nuclear and missile industry. Financial institutions within the territories of EU Member States or under their jurisdiction are prohibited from opening representative offices or new branches, subsidiaries or bank accounts in Iran or establishing joint ventures with a credit or financial institution domiciled in Iran.

Funds and economic resources of those persons and entities listed in Annexes VII and VIII to the EU Regulation are frozen, as they were identified as being engaged in, directly associated with or providing support for Iran's development of nuclear weapon delivery systems.

There are exceptions for making payments due under a judicial, administrative or arbitral decision or pursuant to a contract

entered into prior to the freezing of an account by the sanctions, provided that the funds are paid into a frozen account. Payment due under a lien or contracts entered into prior to the freezing of assets of an entity which are unrelated to the activities prohibited under the sanctions is permitted, provided that the payment is not directly or indirectly received by an Iranian person, body or entity designated in the sanctions. These payments must be notified by the relevant Member State to the Sanctions Committee.

Funds being transferred to or from an Iranian person or entity regardless of location or to or from persons or entities controlled directly or indirectly by an Iranian person are subject to reporting requirements to the Member State's competent authority. Transfers for foodstuffs, healthcare or humanitarian purposes may be carried out without prior authorisation, but transfers above €10,000 must be notified to the relevant competent authority of the Member State. Any other transfer under €40,000 may be carried out without prior authorisation, but must be notified to the relevant competent authority if above €10,000. Transfers above €40,000 must be authorised prior to the transfer by the relevant competent authority. Relevant transfers of funds regardless of whether the transfer is executed in a single operation or in several linked operations in respect of Iranian interests must be notified to the relevant competent authority in advance of the transaction and are deemed authorised within four weeks if not objected to in writing. Member States may charge for authorisation.

Carriers of goods from/to the customs territory of the EU (which includes Monaco, the Channel Islands and the Isle of Man) to/from Iran are required to produce additional pre-arrival or pre-departure information. If they believe, on the basis of the pre-arrival or pre-departure information, that prohibited goods are being carried, Member States can inspect cargo to and from Iran and, if necessary, seize and dispose of the cargo at the expense of the importer/exporter and of the person or entity responsible for the attempted supply, sale or transfer.

The provision of bunkering or ship supply services, or servicing of vessels by a national of Member States to Iranian owned or directly or indirectly controlled vessels is prohibited if that national has information that provides reasonable grounds to believe that the vessel carries items prohibited under the sanctions, other than services necessary for humanitarian purposes.

No claims in connection with any contract or transaction affected, directly or indirectly, by the sanctions including claims for indemnity or any other claim of this type are to be satisfied, if they are made by the Iranian Government, any of the designated persons or entities and any Iranian persons/entities or Iranian controlled persons/ entities. Examples given in the Regulation are claims for compensation or claims under guarantees, and particularly a claim for extension or payment of a bond, guarantee or indemnity.

The freezing of funds and economic resources or the refusal to make funds or economic resources available to designated entities carried out in good faith will not give rise to liability in the absence of negligence.

The prohibitions set out in the Regulation will not give rise to liability, if EU nationals or companies established in the EU did not know and had no reasonable cause to suspect that their actions would infringe the sanctions.

The Regulation applies within the territory of the EU, including its airspace. It applies on board any aircraft or any vessel under the jurisdiction of a Member State and to any person who is an EU national as well as any legal person, entity or body which is incorporated or constituted under the law of a Member State. It also applies to any legal person, entity or body in respect of any business done in whole or in part within the EU.

Other Countries

Sanctions legislation in relation to Iran exists in a number of other countries including:

Australia – The legislation applies to persons in Australia and Australians in and outside Australia and any company they own or control. It also applies to any person using an Australian vessel to transport goods or supply services which are subject to UN sanctions.

Canada – The legislation applies to persons in Canada and Canadians in and outside Canada.

South Korea – The legislation applies to South Korean persons and entities.

Japan – The legislation applies to Japanese entities and persons.

This list is not exhaustive and Members are advised as a minimum to check the legislation in the country in which they and their personnel are established or located.

Club Cover

Club cover in relation to sanctions is based on two principles; first that the Club and hence its mutual membership as a whole should be protected against the risk of the Club being sanctioned and second that cover should not be provided for unlawful trade or activity. These principles are reflected generally in the Rules and particularly in Rule 19 and Rule 8

Rule 19 of the 2011 Rules states:

(1) There is no cover in respect of an insured vessel carrying contraband, blockade running or being employed in an unlawful trade, or if the Committee determines that the carriage, trade, voyage or any other activity on board or in connection with the insured vessel, was imprudent, unsafe, unduly hazardous or improper.

(2) Unless the Committee otherwise determines there is no cover in respect of an insured vessel being employed by the Member in a carriage, trade or on a voyage which thereby in any way howsoever exposes the Club to the risk of being or becoming subject to any sanction, prohibition or adverse action in any form whatsoever by any state or international organisation or other competent authority.

The general exclusion in respect of unlawful trade under paragraph (1) of the Rule would apply where the trade as a whole is unlawful in the jurisdiction in which the Member is situated and/or in the jurisdictions in which the trade is to be performed. For example, a voyage to Iran by a vessel from the EU carrying prohibited cargo such as nuclear materials or key equipment for the oil refining industry would constitute unlawful trade even if the Member employing the vessel was not an EU entity.

The general exclusion would not normally apply where the trade as a whole is lawful, but where performance of part or an element of that trade breaches the sanctions legislation and does not expose the Club itself to sanctions. One example would be failure by a Member to declare to the relevant EU Authority details of a cargo shipped from the EU for Iran. Another would be failure by a Member based in the EU to seek permission to pay port disbursements to an Iranian entity in excess of €40,000. It is important to remember however that fines or penalties paid by a Member for such breaches are recoverable on a discretionary basis from the Club and recovery may be refused if the Club considers that the Member did not take reasonable steps to prevent the breach of the relevant law or regulation.

So far as CISADA is concerned, it is significant that this legislation does not prohibit trade to Iran with refined petroleum products nor does it prohibit activity which could in the opinion of the US Administration directly and significantly support Iran's domestic production of refined petroleum products. Such trade may not be unlawful for the purposes of Rule 19(1).

However, CISADA obliges the US Administration in the form of the State Department to impose sanctions if it believes that the trade or activity is sanctionable. The US Administration can apply those sanctions both to the Member and the Club. If the Member's trade or activity exposes the Club to sanctions in this way, paragraph (2) of Rule 19 will apply and there will be no cover for that trade or activity. This part of Rule 19(2) is designed not only to deal with the risk associated with CISADA type legislation but any circumstance where the Club may be exposed to sanctions as a result of a vessel being employed in a relevant trade. Rule 19(2) does not apply where the trade may expose the Member to the risk of sanctions but not the Club.

How Rule 19 may apply in a particular case will depend of the facts of that case and guidance on its practical application is covered under **Practicalities** below.

Rule 8(4) states that:

The Association shall in no circumstances have a liability to a Member in respect of that part of any liabilities, costs and expenses which is not recovered by the Association from parties to the Pooling Agreement, and/or under the Group Excess Loss Reinsurance Contract or any other reinsurer because of a shortfall in recovery from such parties or reinsurers thereunder by reason of a sanction, prohibition or adverse action against them by a state or international organisation or other competent authority or the risk thereof if payment were to be made by such parties or reinsurers. For the purposes of this Rule 8 "shortfall" includes but is not limited to any failure or delay in recovery by the Association by reason of such parties or reinsurers making payment into a designated account in compliance with the requirements of any state or international organisation or other competent authority.

This Rule reflects the risk that the Club may as a result of sanctions not be able to recover in full or at all under its reinsurances either through the International Group Pool or through the International Group Reinsurance programme or through other specific reinsurance that the Club arranges from time to time. All these insurances are an essential element of the Club's financial strength and its ability to provide high levels of cover to its Members. Many of the Club's reinsurers including the Group Clubs are themselves subject to or affected to a greater or lesser extent by the CISADA, the EU Regulations and additional sanctions legislation in their country of domicile. Although the likelihood of such an occurrence may be low, circumstances could arise where those reinsurers and/or one or more Pool Clubs are prevented by such legislation from paying reinsurance recoveries, respectively their share of Pool or other large claims. The resulting shortfall in the Club's recovery under these reinsurances in respect of a single Member's claim could run to many millions of dollars. Rule 8(4) ensures that the Club and the totality of its membership are protected, even though this may mean that the individual Member who sustains the relevant claim may not receive full indemnity from the Club except on a discretionary basis. As may be expected all other Clubs have incorporated similar provisions into their Rules.

Practicalities

The broad scope of the sanctions legislation in different jurisdictions, the difficulties in its interpretation and the limited guidance provided so far by government enforcement authorities make compliance with the legislation challenging for Members, the Club and other insurers. A risk based but cautious approach appears to be the best way to meet this challenge and there are a number of practical ways in which the risk of the imposition of sanctions or fines or penalties can be avoided or reduced:

1. Know with whom you are doing business

It is advisable before concluding any contract or doing business with Iranian entities or entities which may be owned or controlled by Iranian interests to find out whether they are Specially Designated Nationals in the OFAC list and/or are similarly prohibited or designated individuals or entities under EU regulations or the laws of the flag state or the Member's domicile. In particular diligent steps should be taken to identify the shipper, charterer and consignee of the cargo together, preferably, with details of any end user in Iran.

It may also be necessary to look behind fronting companies or agency arrangements to identify the principal or beneficial owner.

If there is any doubt it is recommended that legal advice is taken before going further with any intended transaction.

2. Understanding the intended trade and voyage

US law prohibits imports and exports between Iran and the US or by US persons or entities wherever they may be. (Similar prohibitions apply to other states such as Cuba, Syria and North Korea.)

CISADA and the EU regulations probably apply to the totality of any carriage from the place of receipt of the goods from the original shipper to delivery to its final consignee. Carriers who perform only part of the overall carriage may find themselves in breach of a prohibition or subject to sanctions.

It is therefore important for Members to find out as much as they can about the origin and ultimate destination of the cargo they intend to carry, particularly where there may be transhipment, forwarding or comingling of cargo. Where a Member performs part of the carriage of a cargo whose final destination is Iran or which originates from Iran, the Member may be exposed to sanctions if the cargo or the carriage in its totality are prohibited or subject to sanctions and if the Member knew or ought to have known about both the cargo and its origin and ultimate destination.

If there is doubt as to the scope of the carriage and whether the destination is Iran legal advice should be sought.

3. Understanding the cargo

Before accepting any cargo destined for Iran and using the US State Department's recent guidance, Members need to consider whether it is a refined petroleum product as defined in CISADA and whether it falls within the broader definition in CISADA of cargo which could directly or indirectly facilitate Iran's domestic production of refined petroleum products or significantly enhance Iran's ability to import such products. Reading the US Departments guidance will assist in this respect. If in doubt seek legal advice.

Similarly checks need to be made against the cargoes detailed in EU 961/2010, Annexes I, II, III and IV. The data about prohibited cargoes in the Regulation is highly technical and again, if in doubt, legal or technical, advice should be sought. If the cargo may contain weapons the Common Military List will also have to be considered.

4. Jurisdiction

Members need to consider what sanctions legislation may apply to them, their subsidiary and parent companies and the vessels themselves in the light of where their companies are registered, operating, based, domiciled or established. The vessels flag state is also a relevant factor as may be the nationality of the ship's officers and crew. It may be lawful for one company in a group to carry on certain trade with Iran but not so for others or the vessel's officers and crew.

5. Payments

Many banks have refused to process payments and receipts linked to Iran or Iranian interests in any way. Not only does this increase the risk to Members of disruption to payments for normal operations such as agency fees, disbursements and bunkering; it also may affect the ability of the Club to pay claims and to provide guarantees to prevent the arrest of an insured vessel or release it from arrest. The Club's ability to respond to a casualty or claim may therefore be restricted or in extreme cases rendered ineffective. Under current permission requirements in EU Regulation 961/2010 for requests to pay more than €40,000 applicants have to wait 4 weeks before permission is deemed to have been given, although it is probably the case that permission may be granted earlier on specific request.

6. Guarantees

It is currently most unlikely that bank guarantees in favour of Iranian claimants can be arranged. Club letters of undertaking may require permission to be issued because they are commitments to pay. The Club will seek guidance from the relevant authority in relation to any payment undertaking to Iranian interests where the amount exceeds €40,000.

In Summary

The various types of legislation present the Club with a particular challenge in terms of ensuring that it does not expose itself and hence the totality of its membership to sanctions or potential shortfall in reinsurance recoveries. But at the same time there is much that can be done to ensure that cover and services to members who trade lawfully with Iran and do not expose the Club to sanctions are maintained to the fullest extent that the legislation permits.

Members are therefore encouraged to consult with the Club at the earliest opportunity when trade with Iran or Iranian interests is contemplated so that the extent of the sanctions risk and the constraints contained in the legislation can be properly assessed and addressed.

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

R J B Searle
Director